

NOV 08 1995

0980-J

ITC 1.29:995/11

---

## INTERNATIONAL ECONOMIC REVIEW

---

United States International Trade Commission  
Office of Economics

Washington DC  
20436

November 1995



*In This Issue:*

**International Economic Comparisons**

**U.S. Trade Developments**

**International Trade Developments:**

*Free Trade Area for the Americas: Chile is Linchpin*

*Japan's Trade with Asia Up as Surplus Declines*

*Trade with Vietnam Off to a Healthy Start*

*India: Implementing Economic Reforms When Federal and State  
Interests Diverge*

*Cooperation Among International Economic Institutions*

**Special Focus:**

*Reform of China's Industrial Enterprises*

**Appendix**

**Statistical Tables**

---

**OFFICE OF ECONOMICS**

**Robert A. Rogowsky, Acting Director**

---

---

The *International Economic Review* is a monthly staff publication of the Office of Economics, U.S. International Trade Commission. The opinions and conclusions it contains are those of the authors and do not necessarily reflect the views of the Commission or of any individual Commissioner. The *IER* is produced as part of the Commission's international trade monitoring program. Its purpose is to keep the Commission informed about significant developments in international economics and trade and to maintain the Commission's readiness to carry out its responsibility to provide technical information and advice on international trade matters to policymakers in the Congress and the Executive branch. The *IER* is available to Government officials outside the Commission on a request basis. The *IER* also is available through the U.S. Department of Commerce's National Trade Data Bank (NTDB). Inquiries or comment on items appearing in the *IER* may be made directly to the author, or to:

Editor, *International Economic Review*  
Trade Reports Division/OE, Room 612  
U.S. International Trade Commission  
500 E Street SW., Washington, DC 20436  
Telephone (202) 205-3255

---

---

# TABLE OF CONTENTS

## **INTERNATIONAL ECONOMIC COMPARISONS**

(Michael Yousef, 202-205-3269) .....	1
--------------------------------------	---

## **U.S. TRADE DEVELOPMENTS**

(Michael Yousef, 202-205-3269) .....	7
--------------------------------------	---

## **INTERNATIONAL TRADE DEVELOPMENTS**

### *Free Trade Area for the Americas: Chile is Linchpin*

The June 1995 meeting of the Western Hemisphere's trade ministers formally launched the work program that has as its goal the creation of a Western Hemisphere free-trade area by 2005. In separate but related activities, the hemisphere's two largest subregional trade blocs, NAFTA and South America's MERCOSUR, are each negotiating for Chile's accession.

(James Stamps, 202-205-3227) .....	11
------------------------------------	----

### *Japan's Trade with Asia Up as Surplus Declines*

Japan's imports have grown faster than exports in the past 1.5 years. Much of the increase is the result of the yen's appreciation, which drove Japanese companies to invest overseas and increase foreign sourcing in an effort to increase competitiveness and profitability.

(Heather Crawford, 202-205-3220) .....	14
--	----

### *Trade with Vietnam Off to a Healthy Start*

Trade between the United States and Vietnam has burgeoned since the end of the U.S. trade embargo in February 1994. The end of the embargo was the first of three recent major developments in U.S.-Vietnamese relations. The United States opened diplomatic relations with Vietnam in July 1995, and Vietnam was added to the Commerce Department's Big Emerging Markets Initiative, also in July.

(Walker Pollard, 202-205-3228) .....	18
--------------------------------------	----

### *India: Implementing Economic Reforms When Federal and State Interests Diverge*

One Indian State's recent efforts to cancel a \$2.8 billion agreement with a U.S. power development company sends warning signals to foreign investors. The government of Indian Prime Minister Rao appears committed to economic reforms. However, India's State governments, which wield considerable constitutional power, ultimately may set the pace of economic liberalization and the country's investment climate.

(James Stamps, 202-205-3227) .....	20
------------------------------------	----

### *Cooperation Among International Economic Institutions*

In June, the G-7 leaders at the Halifax summit agreed to bolster the International Monetary Fund (IMF) in its ability to deal with future financial crises—such as occurred in Mexico in late 1994—as part of their review of how international economic institutions such as the International Monetary Fund, World Bank, World Trade Organization, and others, might usefully cooperate. These issues are on the agenda for an October meeting.

(Ted Wilson, 202-205-3268) .....	23
----------------------------------	----

---

## TABLE OF CONTENTS-Continued

	<i>Page</i>
<b>SPECIAL FOCUS</b>	
<i>Reform of China's Industrial Enterprises</i>	
China's private enterprises have developed vigorously in 1994 and 1995, making impressive increases in production and profits. State enterprises have stagnated, losing their revenues and market shares to collectives, individuals, and foreign firms. Reform of State enterprises is a priority for the Chinese Government in 1995.	
(James Tsao, 202-205-3226) .....	27
<b>APPENDIX</b>	
.....	33
<b>STATISTICAL TABLES</b>	
(Dean Moore, 202-205-3259) .....	39

**THOMAS JENNINGS, Coordinating Editor**

# INTERNATIONAL ECONOMIC COMPARISONS

## Summary of U.S. Economic Conditions

The Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce revised their estimate of real Gross Domestic Product (GDP) growth for the second quarter of 1995 upward to 1.3 percent (\$17.7 billion) at an annual rate. (The previous estimate was 0.5 percent). In the first quarter, real GDP had increased by 2.7 percent at an annual rate.

An increase in consumer spending led to the upward revision of the second quarter growth rate. Real consumer spending increased by \$30.4 billion in the second quarter compared with an increase of \$14.3 billion in the first. Real investment spending, however, increased less than in the first quarter. Most of the decline in investment spending was in producers durable equipment purchases, which increased by \$20.1 billion, compared with an increase of \$35.4 billion in the first quarter. The real change in business inventories subtracted \$16.8 billion from the second quarter change in real GDP. Businesses increased inventories by \$34.3 billion in the second quarter following an increase of \$51.1 billion in the first quarter. Net exports also declined, real exports increased by \$11.4 billion to \$717.6 billion, but imports increased by \$19.7 billion to \$844.3 billion. The trade deficit climbed to \$126.8 billion from \$118.4 billion.

## New featured measures of output and prices

BEA plans to conduct a comprehensive revision of the national income and product accounts by the end of 1995. GDP growth rates calculated using fixed-weight price indexes will be discontinued, and chain-type indexes will be used. The following is an illustration of BEA's new methodology and estimates of real GDP using both sets of weights. The data used for illustration are GDP growth figures released by BEA earlier before their most recent upward revision.

Under the fixed-weighted system, real GDP would have increased by 0.5 percent (at an annual rate) following an increase of 2.7 percent in the first quarter. Under the chain-type method, real GDP would have decreased by 0.2 percent (at an annual rate) in the second quarter following an increase of 1.7 percent in the first quarter. The two weighting methods are applied to deflate GDP components in order to separate the current dollar value into a price change and a quantity change element. The reason for the change to a chain-type weighted measure is to minimize a "substitution bias" associated with applying fixed-price weights.

The substitution bias results when using fixed-price weighted measures for periods other than those close to the base period. Fixing prices at a single period tends to misstate growth as one moves further from the base period. This occurs particularly when commodities with strong output growth receive lower price increases or price declines. A case in point is that of computers, the output of which expanded by 34 percent during 1982-87 but whose prices declined at an average annual rate of 17 percent.

In contrast, the chain-type annual weights uses price weights of adjacent years chained or multiplied together to form a time series. This allows for the effects of changes in relative prices and changes in the composition of output over time, rather than fixed to a base year. Comparing both weighting methods, BEA found that the current fixed-weighted measure overstated real GDP growth estimates of the second quarter of 1995 by 0.7 percent. Whereas the fixed-weighted measure produced a real GDP growth rate of 0.5 percentage point, the chain-type measures produced a decline of 0.2 percentage point. BEA also found that current economic expansions are overstated by 0.5 percentage point and past expansions are understated by about 0.5 percentage point.

Other improvements to BEA's accounting measures, include the following: (1) implementation of an improved empirical basis for the estimates of depreciation and capital stocks, (2) the treatment of government purchases of structures and equipment as investment, (3) the incorporation of newly available source data, such as the 1987 benchmark input-output

tables and data from the 1992 Economic Censuses and several annual surveys for 1993 and 1994, and (4) the use of improved estimating methodologies. BEA maintains that all of these changes will have a beneficial impact on the analysis of productivity, returns to investment, and the long-term potential for the economy.

Table 1 shows estimates of GDP using the fixed-type and chain-type measures. The substitution bias is relatively larger in gross private fixed investment, particularly producers durable equipment, and in the export and import sectors. This is probably because these sectors contain computers and other commodities, for which prices tend to increase more slowly or decline as their production rises and therefore are prone to greater substitution bias when the fixed-type measure is used.

### *International comparisons of manufacturing productivity and unit labor cost*

In the Bureau of Labor Statistics reported that U.S. manufacturing productivity increased by 4.0 percent at an annual rate in 1994, output increased by 6.4 percent, and unit labor costs decreased by 2.3 percent. Manufacturing productivity in Denmark, France, Germany, and the Netherlands increased on average by 7.5 percent. Japan's productivity grew by 2.9 percent; Italy's, by 3.6 percent; and Norway's, by 1.0 percent. Japan, France, Germany and the Netherlands, however, attained higher productivity gains by reducing hours worked.

Output rose the most in Sweden, by 10.7 percent; followed by Denmark, 8.5 percent; and Canada, 6.7 percent. Output in Japan increased by less than 1 percent. Unit labor costs rose the most in Japan, by 7.6 percent. Unit labor costs declined markedly in Canada, by 6.5 percent. In Denmark, France, Germany, Italy, and the Netherlands, unit labor costs declined with the highest decline recorded in Italy, as illustrated in table 2.

### *Long-term productivity comparisons*

During the period 1970-94, BLS reported that U.S. productivity in manufacturing increased at an average annual rate of 2.5 percent, exceeding Canada, Denmark, Germany, and Norway in productivity gains. During the same period, Japan attained the highest productivity gains, averaging 4.3 percent, followed by Italy and the United Kingdom, which both gained 4.0 percent. U.S. output increased by 1.9 percent at an

annual rate exceeding manufacturing output growth in Canada, Denmark, France, Germany, the Netherlands, Norway, Sweden and the United Kingdom. U.S. unit labor costs rose moderately, by 2.4 percent at an annual rate, lower than the rise in Canada, Japan, Denmark, Germany, and Norway, and the United Kingdom but more than the rise in Italy, Netherlands, and Sweden.

U.S. productivity and labor costs performance has improved in the 1990's. During 1990-94, U.S. productivity gains in manufactures averaged 3.0 percent annual rate, the highest rate of increase since 1979. U.S. gains exceeded those of Canada, Japan, France, Germany, the Netherlands, and Norway, but fell short of productivity gains in Denmark, Italy, Sweden, and the United Kingdom. U.S. manufacturing output increased considerably faster than that in the other countries, and unit labor costs rose very slowly, by 0.5 percent, as shown in table 3.

### **U.S. Economic Performance Relative to other Group of Seven (G-7) Members**

#### *Economic growth*

U.S. real GDP—the output of goods and services produced in the United States measured in 1987 prices—grew at a revised annual rate of 1.3 percent in the second quarter following an increase of 2.7 percent in the first quarter of 1995. Real GDP increased by 4.1 percent in 1994.

The annualized rate of real GDP growth in the second quarter of 1995 was -1.0 in Canada, 1.3 percent in France, 4.3 percent in Germany, 3.1 percent in Japan, and 1.9 percent in the United Kingdom. In the first quarter real GDP growth was 6.0 percent in Italy.

#### *Industrial production*

U.S. industrial production gained 1.1 percent in August 1995 following 7 months of either small increases or declines. Output posted a revised gain of 0.3 percent in July 1995. Manufacturing output increased by 1.0 percent in August led by sharp gains in the output of motor vehicles and of related parts and materials. Most other industries posted output increases. Utilities output surged 5.0 percent because of the hot weather. In August 1995, industrial production was 3.2 percent higher than that of a year ago. Capacity utilization rose by 0.6 percentage point, to 84.3 percent in August 1995, and was 3.5 percent higher than in August 1994. Capacity utilization in

Table 1

Changes from preceding period in specified components of Gross Domestic Product using alternative methods of weighting, seasonally adjusted annual rates, 1993-94 and by quarters, January 1994-June 1995

(Percent)

Item	1993	1994	1994				1995		
			I	II	III	IV	I	II	
<b>GDP:</b>									
Current dollars .....	5.4	6.2	6.1	7.2	6.2	6.4	4.7	2.0	
Quantity indexes:									
Fixed 1987 weights .....	3.1	4.1	3.3	4.1	4.0	5.1	2.7	.5	
Chain-type annual weights .....	2.5	3.6	3.2	4.2	3.8	4.0	1.7	-.2	
Consumption expenditure									
Current dollars .....	5.8	5.7	6.0	4.6	6.3	6.8	4.1	4.8	
Quantity indexes									
Fixed 1987 weights .....	3.3	3.5	4.7	1.3	3.1	5.1	1.6	2.5	
Chain-type annual weights .....	2.9	3.2	4.3	1.4	2.9	4.4	1.4	2.2	
Gross private domestic investment									
Current dollars .....	11.9	17.1	20.5	31.1	8.2	8.0	12.5	-7.2	
Quantity indexes									
Fixed 1987 weights .....	13.0	16.1	18.0	25.2	7.1	9.3	14.9	-3.2	
Chain-type annual weights .....	10.4	14.7	17.3	27.8	5.6	6.6	12.6	-8.1	
Producers durable equipment									
Current dollars .....	13.4	16.3	21.2	7.3	19.6	12.9	21.6	4.0	
Quantity indexes									
Fixed 1987 weights .....	18.0	17.6	18.6	6.1	18.1	19.6	24.5	12.7	
Chain-type annual weights .....	13.7	15.6	19.3	4.8	18.6	16.1	23.2	3.2	
Exports of goods & services									
Current dollars .....	3.3	9.0	-3.5	19.2	15.6	20.6	7.1	10.2	
Quantity indexes									
Fixed 1987 weights .....	4.1	9.0	-3.5	16.6	14.8	20.2	4.8	7.2	
Chain-type annual weights .....	2.7	7.3	-5.6	16.5	12.8	17.1	1.9	5.1	
Imports of goods & services									
Current dollars .....	8.4	12.8	5.2	23.5	20.3	12.1	12.3	14.4	
Quantity indexes									
Fixed 1987 weights .....	10.7	13.4	9.5	18.9	15.6	11.4	10.1	9.4	
Chain-type annual weights .....	6.9	11.7	8.3	17.4	13.1	8.7	9.9	7.5	
Government purchases:									
Current dollars .....	2.1	2.3	.9	2.4	7.8	-1.0	4.4	3.3	
Quantity indexes									
Fixed 1987 weights .....	-.8	-.8	-4.9	-1.2	8.7	-4.1	-.7	-.3	
Chain-type annual weights .....	-.9	-.6	-3.4	-1.4	5.9	4.4	-.7	-.2	
Federal Government									
Current dollars .....	-1.2	-1.4	-1.8	-2.4	8.7	-10.7	2.3	0	
Quantity indexes									
Fixed 1987 weights .....	-4.5	-5.3	-10.3	-7.9	10.9	-14.4	-3.8	-3.1	
Chain-type annual weights .....	-4.6	-4.9	-7.0	-8.0	9.1	-14.9	-3.7	-2.8	

Source: Bureau of Economic Analysis, Survey of Current Business, July 1995.

**Table 2**  
**Annual changes in manufacturing productivity and labor costs in 11 countries, 1993-94**  
 (Percent)

Country	Productivity	Output	Hours	Hourly compensation	Unit labor cost
United States	4.0	6.4	2.3	1.7	-2.3
Canada	4.0	6.7	2.6	3.0	-6.5
Japan	2.9	.8	-2.1	1.9	7.6
Denmark	7.5	8.5	.9	3.0	-2.2
France	7.6	4.8	-2.6	2.6	-2.6
Germany	7.3	2.5	-4.5	4.1	-1.0
Italy	3.6	5.3	1.6	1.1	4.7
Netherlands	7.3	3.8	-3.3	1.4	-3.4
Norway	1.0	5.0	3.9	2.7	2.3
Sweden	5.1	10.7	5.3	5.0	1.0
United Kingdom	4.1	4.1	.0	4.0	1.9

Source: U.S. Department of Labor, Bureau of Labor Statistics, International Comparisons of Manufacturing Productivity and Unit Labor Cost Trends, 1994.

**Table 3**  
**Average annual rates of change in manufacturing productivity, output, and labor costs, by specified countries, 1979-94**

Country	1979-94	1979-85	1985-90	1990-94	1991	1992	1993	1994
<b>Productivity</b>								
United States	2.5	2.0	2.7	3.0	2.3	2.1	3.6	4.0
Canada	1.8	2.4	.4	2.8	.7	4.2	2.3	4.0
Japan	4.3	4.6	5.4	2.4	5.2	-2	1.9	2.9
Denmark	1.7	2.1	.1	3.2	1.9	1.9	1.5	7.5
France	3.1	3.0	3.4	2.8	-4	3.1	.9	7.6
Germany	2.2	2.1	2.1	2.8	3.6	-1.2	1.5	7.3
Italy	4.0	5.0	2.6	4.1	3.2	5.0	4.6	3.6
Netherlands	3.1	4.4	1.9	2.6	1.0	.4	1.9	7.3
Norway	2.1	2.9	1.5	1.7	-.5	4.1	2.1	1.0
Sweden	2.9	3.0	1.7	4.2	0	5.3	6.6	5.1
United Kingdom	4.0	4.1	3.8	4.3	3.7	4.8	4.5	4.1
<b>Output</b>								
United States	1.9	.7	2.8	2.7	-1.9	1.5	5.0	6.4
Canada	1.4	1.5	1.5	1.2	-0.9	.7	5.0	8.7
Japan	4.4	5.6	5.6	.6	6.3	-2.0	-2.5	.8
Denmark	1.4	2.9	-.5	1.5	-.1	1.0	-3.1	8.5
France	.6	-.4	2.6	-.5	-1.8	-.1	-4.6	4.8
Germany	.6	-.2	2.3	-1.0	3.7	-2.3	-7.7	2.5
Italy	2.2	1.8	4.0	.7	-.2	.4	-2.6	5.3
Netherlands	1.8	1.8	3.1	.3	.5	-.6	-2.2	3.8
Norway	2	1.0	-1.7	1.6	-3.3	3.2	1.7	5.0
Sweden	1.4	2.2	1.2	.4	-6.4	-3.4	1.6	10.7
United Kingdom	.6	-1.2	3.4	-2	-5.4	-.6	1.3	4.1
<b>Unit labor costs (U.S. dollar basis)</b>								
United States	2.4	4.9	1.1	0.5	3.0	2.1	-0.8	-2.3
Canada	2.8	3.4	7.1	-3.3	7.6	-5.4	-8.1	-6.5
Japan	5.4	-1.4	9.7	10.9	8.3	10.6	17.1	7.6
Denmark	2.9	-5.8	17.2	-.1	-1.4	8.2	-4.7	-2.2
France	2.4	-3.4	11.6	.4	1.5	7.0	-4.0	-2.6
Germany	4.1	-4.1	15.9	2.9	.2	18.5	-.2	-1.0
Italy	1.7	-3.3	14.3	-5.1	3.4	3.0	-20.2	-4.7
Netherlands	1.3	-7.6	12.9	1.3	.8	11.6	-2.9	-3.4
Norway	2.9	-2.1	13.5	-1.7	2.2	3.0	-13.5	2.3
Sweden	.7	-5.3	14.8	-6.4	6.6	3.2	-30.9	1.0
United Kingdom	2.7	-1.3	10.5	-.4	5.4	5.0	-12.7	1.9

Note.—Although productivity relates output to hours of persons employed in manufacturing, it does not measure the contribution of labor factor alone. It reflects the joint effects of many factors including technology, capital investment, capacity utilization, managerial skills, and others.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

manufacturing rose in August by 0.5 percent, to 83.0 percent, and was 3.9 percent higher than that of a year ago.

Other Group of Seven (G-7) member countries reported the following growth rates of industrial production. For the year ending July 1995, Germany reported an increase of 3.1 percent, Japan, an increase of 1.3 percent and the United Kingdom, an increase of 1.6 percent. For the year ending June 1995, Canada reported an increase of 2.7 percent, Italy, an increase of 5.0 percent, and France, an increase of 4.4 percent.

## *Prices*

The seasonally adjusted U.S. Consumer Price Index (CPI) rose by 0.1 percent in August following a 0.2-percent increase in July 1995. For the 12-month period ended in August 1995, the CPI increased by 2.6 percent.

During the 1-year period ended August 1995, prices increased by 2.3 percent in Canada, 1.9 percent in France, 1.7 percent in Germany, 5.8 percent in Italy, 0.1 percent in Japan, and 3.6 percent in the United Kingdom.

## *Employment*

The Bureau of Labor Statistics reported that the unemployment rate in August 1995 was essentially unchanged at 5.6 percent. Unemployment rates were about the same in August as in July for adult men (4.8 percent), adult women (5.0 percent), teenagers (17.7 percent), whites (4.8 percent), blacks (11.3 percent) and Hispanics (9.9 percent).

The services industry added 144,000 jobs in August, following little growth in the prior month. Manufacturing employment was almost unchanged in August, after a particularly sharp decline in July and smaller losses in the prior 3 months. Durable goods

regained one-half of its July employment loss, with increases concentrated in electronic equipment and industrial machinery. Employment in nondurable goods continued to decline, with the largest losses occurring in apparel and printing and publishing. Construction employment was flat in August.

In other G-7 countries, unemployment in August 1995 was 9.6 percent in Canada, 11.4 percent in France, 9.4 percent in Germany, 11.3 percent in Italy, 3.2 percent in Japan, and 8.2 percent in the United Kingdom.

## *Forecasts*

Forecasters expect real growth in the United States to average around 2.0 percent (annual rate) in the third quarter of 1995 and then to accelerate to an average of 2.8 percent (annual rate) in the fourth quarter and the first half of 1996. Factors that may restrain growth in 1995 and 1996 include the impact of high interest rates on housing and on consumer spending, the large inventory overhang, and the contractionary impact of the decline in government spending. Table 4 shows macroeconomic projections by six major forecasters for the U.S. economy from July 1995 to June 1996, and the simple average of these forecasts. Forecasts of all the economic indicators, except unemployment, are presented as percentage changes over the preceding quarter, on an annualized basis. The forecasts of the unemployment rate are averages for the quarter.

The average of the forecasts points to an unemployment rate ranging between 5.8 and 5.9 percent in the remainder of 1995. Inflation (as measured by the GDP deflator) is expected to remain subdued at an average rate of about 2.3 to 3.0 percent. The slowdown in general economic activity during 1995 is expected to keep inflation down and unemployment high.

**Table 4**  
**Projected changes of selected U.S. economic indicators, by quarters, July 95-June 96**  
*(Percent)*

Period	Confer- ence Board	E.I. Dupont	UCLA Business Forecasting Project	Merrill Lynch Capital Markets	Data Resources Inc. (D.R.I.)	Wharton WEFA Group	Mean of 6 fore- casts
GDP current dollars							
1995:							
July-Sept. ....	7.1	2.9	2.4	4.5	4.2	6.5	4.6
Oct-Dec. ....	7.6	5.3	3.4	5.0	3.9	5.5	5.1
GDP constant (1987) dollars							
1995:							
July-Sept. ....	3.7	1.8	0.8	1.4	1.8	2.4	2.0
Oct-Dec. ....	5.9	2.7	1.6	2.7	1.7	2.1	2.8
1996:							
Jan.-Mar. ....	3.8	2.8	3.0	3.1	3.0	1.4	2.8
Apr.-June ....	4.1	2.7	3.1	2.8	2.2	1.6	2.7
GDP deflator index							
1995:							
July-Sept. ....	3.2	1.0	1.6	3.1	2.3	4.0	2.5
Oct-Dec. ....	1.8	2.5	1.7	2.3	2.2	3.3	2.3
1996:							
Jan.-Mar. ....	3.4	2.8	3.3	2.4	2.5	3.5	3.0
Apr.-June ....	2.5	2.5	3.3	2.2	2.5	3.3	2.7
Unemployment, average rate							
1995:							
July-Sept. ....	5.5	5.7	6.2	6.0	5.7	5.9	5.8
Oct-Dec. ....	5.3	5.8	6.3	6.1	5.7	6.0	5.9
1996:							
Jan.-Mar. ....	5.2	5.8	6.3	6.0	5.7	6.2	5.9
Apr.-June ....	5.2	5.9	6.3	5.8	5.8	6.3	5.9

Note.—Except for the unemployment rate, percentage changes in the forecast represent annualized rates of change from preceding period. Quarterly data are seasonally adjusted. Date of forecasts: September 1995.

Source: Compiled from data provided by the Conference Board. Used with permission.

---

## U.S. TRADE DEVELOPMENTS

The U.S. Department of Commerce reported that seasonally adjusted exports of goods and services of \$63.1 billion and imports of \$74.6 billion in July 1995 resulted in a goods and services trade deficit of \$11.5 billion, 0.2 billion more than the June deficit. The July 1995 deficit was \$0.7 billion more than the deficit registered in July 1994 (\$10.8 billion) and was \$1.7 billion higher than the average monthly deficit registered during the previous 12 months (\$9.8 billion).

The July 1995 trade deficit on goods was \$16.6 billion, approximately \$93 million higher than the June

deficit. The July services surplus was \$5.1 billion, \$124 million lower than the June surplus.

Seasonally adjusted U.S. trade in goods and services is shown in table 5. Nominal export changes and trade balances for specific major commodity sectors are shown in table 6. U.S. exports and imports of goods with major trading partners on a monthly and year-to-date basis are shown in table 7, and U.S. trade in services, by major categories, is shown in table 8.

**Table 5**  
**U.S. trade in goods and services, seasonally adjusted, June-July 95**  
*(Billion dollars)*

Item	Exports		Imports		Trade balance	
	July 95	June 95	July 95	June 95	July 95	June 95
<b>Trade in goods (Balance of payments basis)</b>						
Current dollars—						
Including oil .....	46.1	47.4	62.6	63.9	-16.6	-16.5
Excl'ng oil .....	46.2	47.6	57.7	57.9	-11.6	-10.3
<b>Trade in services</b>						
Current dollars .....	17.0	17.2	11.9	12.0	5.1	5.2
<b>Trade in goods and services</b>						
Current dollars .....	63.1	64.6	74.6	75.9	-11.5	-11.3
<b>Trade in goods (Census basis)</b>						
1987 dollars .....	45.6	46.5	60.2	60.4	-14.6	-13.9
Advanced-technology products (not season- ally adjusted) .....	10.6	12.0	10.4	10.6	0.2	1.4

Note.—Data on goods trade are presented on a BOP basis that reflects adjustments for timing, coverage, and valuation of data compiled by the Census Bureau. The major adjustments on BOP basis exclude military trade, but include nonmonetary gold transactions, and estimates of inland freight in Canada and Mexico, not included in the Census Bureau data.

Source: U.S. Department of Commerce *News (FT 900)*, September 1995.

**Table 6**  
**Nominal U.S. exports and trade balances of agriculture and specified manufacturing sectors,**  
**Jan. 1994-July 1995**

Sector	Change					
	Exports		July 1995	Jan.- July 1995	July 1995 over June 1994	Jan.- July 1995 over Jan.- July 1994
	July 1995	Jan.- July 1995				
ADP equipment and office machinery .....	2.8	19.6	-9.7	15.3	5.9	-13.6
Airplanes .....	.9	8.6	-35.7	-24.6	2.6	6.5
Airplane parts .....	.5	5.8	-11.1	5.5	1.7	4.3
Electrical machinery .....	4.2	29.4	-6.7	17.6	8.8	-11.4
General industrial machinery .....	1.9	13.8	-5.0	13.1	4.2	-0.5
Iron and steel mill products .....	.5	2.7	0	35.0	0.8	-5.0
Inorganic chemicals .....	.3	2.6	-25.0	18.2	0.8	-0.1
Organic chemicals .....	1.3	9.5	-13.3	33.8	2.9	1.5
Power-generating machinery .....	1.6	12.3	-5.9	6.0	3.7	0.2
Scientific instruments .....	1.5	10.5	0	11.7	3.2	3.9
Specialized industrial machinery .....	1.9	13.3	-5.0	20.9	4.0	1.4
Telecommunications .....	1.6	10.6	0	21.8	3.2	-8.5
Textile yarns, fabrics and articles .....	.5	4.1	-16.7	13.9	1.2	-1.9
Vehicle parts .....	1.3	13.5	-27.8	16.4	4.1	1.7
Other manufactured goods <sup>1</sup> .....	2.3	18.1	-14.8	13.8	5.4	-7.2
Manufactured exports not included above .....	10.6	83.0	-13.8	12.2	25.0	-72.4
Total manufactures .....	34.0	257.4	-11.7	12.8	77.5	-101.1
Agriculture .....	3.9	30.5	0	28.6	9.2	13.1
Other exports not included above .....	6.3	44.4	-7.4	23.9	13.3	-4.8
Total exports of goods .....	44.2	332.3	-10.2	15.7	100.0	-92.6

<sup>1</sup> This is an official U.S. Department of Commerce commodity grouping.

Note.—Because of rounding, figures may not add to the totals shown.

Data are presented on a Census basis.

Source: U.S. Department of Commerce News (FT 900), September 1995.

**Table 7**  
**U.S. exports and imports of goods with major trading partners, Jan. 1994-July 1995**  
*(Billion dollars)*

Country/Area	Exports			Imports		
	July 95	Jan.- July 95	Jan.- July 94	July 95	Jan.- July 95	Jan.- June 95
North America .....	11.8	99.0	92.1	14.5	117.5	97.0
Canada .....	8.3	73.0	63.4	9.8	82.6	70.0
Mexico .....	3.5	25.9	28.7	4.7	34.9	27.0
Western Europe .....	9.9	77.0	67.7	13.0	84.7	73.5
European Union (EU) .....	9.2	70.2	61.4	11.8	76.8	67.3
Germany .....	1.7	12.8	10.8	3.6	21.5	17.9
European Free-Trade Association (EFTA) <sup>1</sup> .....	.5	4.8	4.3	1.0	6.4	5.0
Former Soviet Union/Eastern Europe .....	.5	3.1	2.9	.5	4.5	3.0
Former Soviet Union .....	.3	2.0	2.0	.3	3.2	1.9
Russia .....	.2	1.8	1.5	.2	2.7	1.7
Pacific Rim Countries .....	15.0	102.3	83.1	25.5	163.5	142.4
Australia .....	.9	6.2	5.4	.3	1.9	1.8
China .....	1.0	6.5	5.7	4.3	24.4	20.0
Japan .....	5.5	36.4	30.2	10.6	73.9	68.3
NICs <sup>2</sup> .....	6.1	42.4	32.9	7.2	44.5	38.9
South/Central America .....	4.0	28.6	22.5	3.5	24.3	21.3
Argentina .....	.3	2.3	2.6	.1	1.0	1.0
Brazil .....	.8	6.7	4.0	.7	5.0	4.9
OPEC .....	1.5	11.4	10.1	3.1	20.3	17.4
Total .....	44.2	332.3	287.3	61.8	425.1	384.2

<sup>1</sup> Includes Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland.

<sup>2</sup> The newly industrializing countries (NICs) include Hong Kong, the Republic of Korea, Singapore, and Taiwan.

Note.—Because of rounding, figures may not add to the totals shown. Exports of certain grains, oilseeds and textiles are excluded from country/area exports but are included in total export table. Also, some countries are included in more than 1 area. Based on Census Bureau data.

Source: U.S. Department of Commerce News (FT 900), September 1995.

**Table 8**  
**Nominal U.S. exports and trade balances of services, by sectors, Jan. 1994-July 1995, seasonally adjusted**

	Exports			Change	
	Jan.- July 95	Jan.- July 94	Billion dollars	Trade balances	
				over	Jan.- July 95
Travel .....	35.3	34.7	1.7	9.2	9.5
Passenger fares .....	10.5	10.0	5.0	2.9	2.7
Other transportation .....	16.3	14.5	12.4	-0.8	-1.6
Royalties and license fees .....	15.0	12.7	18.1	11.3	9.4
Other private services <sup>1</sup> .....	35.4	34.0	4.1	13.8	13.4
Transfers under U.S. military sales contracts .....	7.0	7.0	0	1.2	.7
U.S. Government miscellaneous services .....	.4	.5	-20.0	-1.2	-1.1
Total .....	119.9	113.4	5.7	36.4	33.0

<sup>1</sup> Consists of transactions with affiliated and unaffiliated foreigners. These transactions include educational, financial, insurance, telecommunications, and such technical services as business, advertising, computer and data processing, and other information services, such as engineering, consulting, and others.

Note.—Services trade data are on a Balance-of-Payments (BOP) basis. Because of seasonal adjustment and rounding, figures may not add to the totals shown.

Source: U.S. Department of Commerce News (FT 900), September 1995.

# INTERNATIONAL TRADE DEVELOPMENTS

## Free Trade Area for the Americas: Chile is the Linchpin

The June 1995 meeting of the Western Hemisphere's trade ministers marked the formal launch of work to create the Free Trade Area for the Americas (FTAA). These coordinated hemispherewide efforts for the FTAA coincide with ongoing evolution of the hemisphere's many subregional trade agreements. The largest such subregional group, the North American Free Trade Agreement (or NAFTA, which comprises the United States, Canada, and Mexico), has initiated negotiations to add Chile to the free-trade area. The second largest group, the Southern Common Market (or MERCOSUR, which comprises Argentina, Brazil, Paraguay, and Uruguay), also has started talks to add Chile to its customs union as well as to include other South American countries.

This article addresses the current and anticipated work plan for the FTAA and assesses, against this background, efforts to expand NAFTA and MERCOSUR as each subregional group negotiates the accession of Chile and vies to become a hemispheric hub for the FTAA.

By far the most ambitious plan for hemispheric economic cooperation to date was launched at the December 1994 Summit of the Americas in Miami, FL. On December 11, 1994, the hemisphere's 34 democratically elected leaders (only Cuba was not represented) signed a Declaration of Principles in which they "resolve to begin immediately to construct the Free Trade Area of the Americas (FTAA) in which barriers to trade and investment will be progressively eliminated.... to conclude the negotiations of the Free Trade Area of the Americas no later than 2005, and agree that concrete progress toward the attainment of this objective will be made by the end of this century." The leaders also approved an Action Plan that called for their respective trade ministers to meet in June 1995 to draft a more complete plan for FTAA negotiations and to meet again in March 1996 to develop a timetable for future work. In a separate joint statement also released December 11, 1994, President

Clinton, Prime Minister Jean Chretien of Canada, President Eduardo Frei of Chile, and President Ernesto Zedillo of Mexico stated their intention to begin negotiations for Chile to accede to NAFTA.

## FTAA: Denver Ministerial

Trade ministers of the 34 western hemisphere countries met in Denver, CO. on June 29-30, 1995. The meeting culminated when all 34 ministers signed a Joint Declaration and Work Plan in which they agreed to set up FTAA working groups. The seven working groups are for market access, customs procedures and rules of origin, investment, standards and technical barriers to trade, sanitary and phytosanitary measures, subsidies, and smaller economies. The working groups are to identify and examine existing trade-related measures in each area, with a view to identifying possible approaches to FTAA negotiations. Each working group is to draft a report to be presented at the scheduled March 1996 ministerial meeting. The ministers also agreed that additional working groups for government procurement, intellectual property rights, services, and competition policy—areas in which agreement proved particularly controversial—will be established during the March 1996 ministerial.

Dispute settlement was the only issue addressed at the Miami Summit's Action Plan that was neither taken up at the June 1995 ministerial nor mentioned as an item to be considered at the March 1996 meeting. Several sources reported that there was "widespread feeling" that efforts at this stage should support the dispute procedures in the World Trade Organization (WTO) and not strive to set up new procedures in the FTAA context at this time.

Sharp differences surfaced among trade ministers on several key issues during the June meeting. Working groups were not established for the areas of labor and the environment even though the Miami Summit's Action Plan agreed to "further secure the observance and promotion of worker rights" and to make trade liberalization and environmental policies "mutually supportive." At a May 10-11 "all nations" preparatory meeting of the hemisphere's vice trade ministers, many Latin American representatives

expressed concerns about a U.S. proposal to include labor and environmental ministers as well as concerned private groups in the FTAA process. Opposition to the U.S. proposal mounted on the grounds that neither issue merited inclusion in the immediate action plan required to advance the FTAA process. Moreover, some participants argued that the proposed U.S. language on labor and the environment departed from the more vaguely worded language on labor and the environment in the Miami Summit's Action Plan. Sources monitoring the pre-Denver consultations reported that the United States agreed to curb its proposed language to achieve consensus at the June ministerial.

The June ministerial failed to resolve two key points of disagreement about the future path of FTAA negotiations: (1) the scope of the FTAA negotiations and (2) the approach to be used to achieve the FTAA. In remarks reproduced by *Inside NAFTA* (July 4, 1995), Canadian Minister for International Trade Roy MacLaren stated that the June ministerial left unresolved the question of how ambitious the scope of FTAA negotiations should be beyond tariff elimination. Specifically, Minister MacLaren set out for consideration whether FTAA should aim for provisions that go beyond those set forth in the WTO and the NAFTA, such as the elimination of agricultural export subsidies by member countries.

Opinions diverged on the approach that should be used to achieve the FTAA. United States Trade Representative Mickey Kantor and Canadian Minister MacLaren both viewed the FTAA as a two-track integration process—the newly established FTAA working groups as one track and deepening and strengthening of existing subregional trade agreements as the other track. In this view, the working group discussions and the existing subregional agreements would be mutually reinforcing and ultimately "converge."

A different perspective advocated modeling FTAA negotiations after GATT/WTO negotiations. This scenario envisions a multilateral forum open to all 34 countries to simultaneously negotiate the FTAA. At the other end of the spectrum, Brazilian Foreign Minister Luiz Felipe Lampreia articulated an approach based on widening and deepening the existing subregional agreements. The subregional accords then would become "building blocks" for broader hemispheric economic integration along a path that ultimately would lead to bloc-to-bloc negotiations. Advocates maintain that by capturing the gains and building on the progress already made in the subregional trade blocs, such an approach could achieve FTAA objectives faster than the GATT model. However, critics of the "building block" approach argue that much time could be lost in efforts to harmonize a

diverse group of subregional arrangements ranging from free-trade areas such as NAFTA to customs unions such as MERCOSUR.

A recent report by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) commented on these issues (see ECLAC, *Reflections on Ways to Approach the Topic of the Free Trade Area of the Americas*, June 4, 1995). In order to achieve the goal of the FTAA, the report recommends that existing subregional trade blocs use their Uruguay Round commitments as the benchmark in establishing their respective trade rules. The ECLAC report also advises the continued examination of alternative courses to a hemispherewide agreement. Further, the report states that emphasis should be "placed on what was agreed upon in the context of NAFTA on such matters as rules of origin and dispute resolution," but cautions that on matters such as countervailing and antidumping duties and agricultural subsidies, "an endeavor should be made to achieve greater progress than that resulting from the Uruguay Round and NAFTA negotiations."

## NAFTA: Chilean Accession

Chilean accession to NAFTA is set to be the first concrete achievement towards creation of the FTAA. The addition of Chile, with a population of 13 million people and GDP of \$97 billion, would have little overall economic impact on NAFTA's internal market of over 376 million people and combined GDP of nearly \$8 trillion. However, Chilean accession to NAFTA stands as an important symbol of a commitment particularly on the part of the United States to closer economic cooperation with the rest of Latin America. For its part, Chile currently has a free-trade agreement with Mexico (see *International Economic Review*, November 1994) under which 80 to 85 percent of bilateral trade will be duty-free by January 1, 1996, and virtually all bilateral trade will be duty-free by 1998.

The first "informal" technical discussions among the NAFTA countries and Chile occurred in April 1995. Trade ministers from the four countries met in Toronto, Canada, on June 7 to draft a work schedule for the completion of negotiations by the end of 1995. The first rounds of working level negotiations, consisting primarily of information exchanges, occurred during July 24-August 1 and September 6-8 in Mexico City. Further working-level sessions and another meeting of trade ministers occurred in September 1995.

Key to Chilean accession to NAFTA is U.S. congressional authorization of fast-track negotiating authority. Fast-track authority limits Congress' involvement to a yes-or-no vote on the trade pact once

negotiations conclude. Fast-track authority allows negotiators to work out details of a trade agreement with the confidence that the deal will remain unaltered through the congressional approval process. Although fast-track authority technically is not necessary for the United States to complete the negotiations, the authority ultimately is considered necessary to ensure that legislation consistent with the final agreement is passed by Congress in a timely fashion.

President Clinton had pledged to begin free-trade negotiations with Chile once NAFTA and Uruguay Round negotiations were complete in 1994. However, in September 1994 the Clinton administration was forced to drop a request for fast-track negotiating authority from the Uruguay Round implementation legislation passed in December 1994. In 1995, the administration's new request for fast-track authority became caught in a disagreement with Congress. In July 1995, Ambassador Kantor stated that the administration would seek to include labor and environmental issues as part of an agreement on Chile's accession to NAFTA.<sup>1</sup> Some members of Congress have sought to exclude possible supplemental agreements on labor and the environment because of the concern that such agreements could impede trade and lead to tougher regulations on U.S. businesses abroad; they also questioned whether such agreements should be formally approved by Congress. A bipartisan congressional delegation visiting Chile in early August 1995 reassured Chilean officials that the congressional debate over extending fast track did not reflect opposition to Chilean accession to NAFTA. Through late October 1995, Clinton administration and congressional officials continued to negotiate mutually agreeable language for possible fast-track authority.

Having lobbied the United States for a free-trade agreement since 1992, Chilean officials see the granting of fast-track authority as a sign that the United States finally is committed to completing the negotiations. Undoubtedly concerned that the NAFTA accession negotiations could drag into 1996 and become hostage to U.S. presidential election-year politics, Chilean officials recently stepped up efforts to prod U.S. policymakers into action. In late July 1995, Chilean Economy Minister Alvaro García announced that Chile would not negotiate substantive issues in the

<sup>1</sup> The U.S. NAFTA-implementing bill was accompanied by several supplementary agreements, including supplemental agreements with Canada and Mexico on environmental and labor cooperation. These were executive agreements that did not require domestic legislation or formal approval by Congress. The agreements have as broad objectives to foster the conservation, protection, and improvement of the environment and to improve working conditions. The supplemental agreements establish commissions and advisory boards to foster cooperation and to monitor relevant laws and their enforcement.

NAFTA accession talks, such as tariff phaseout schedules for specific goods or liberalization of specific services, until it becomes clear that fast track will be approved.

In addition to labor and environmental issues, negotiations for Chilean accession have brought to the forefront other concerns about issues already negotiated in the NAFTA agreement. This first effort to expand NAFTA prompted eight U.S. Senators to write to President Clinton in late August requesting that the NAFTA chapter 19 dispute settlement process not be extended to Chile. (NAFTA creates several mechanisms for the resolution of disputes that supplement WTO dispute settlement mechanisms. One of these, contained in NAFTA chapter 19, allows private parties to appeal antidumping and countervailing duty decisions to binational panels.) During August 1995, the U.S. Embassy in Ottawa reported that there were numerous Canadian press reports that the United States had sought to use the Chilean accession talks as an opportunity to reopen NAFTA in the areas of agricultural export subsidies, intellectual property rights, and basic telecommunications. The U.S. administration stated that it does not intend to reopen NAFTA in the context of Chilean accession.

## MERCOSUR

With a population of 198 million individuals and combined GDP of \$1 trillion, the MERCOSUR market (comprising Argentina, Brazil, Paraguay, and Uruguay) is significantly smaller than the combined NAFTA market but is nearly twice as large as any other existing subregional Latin American group. MERCOSUR operates as a common market. Tariffs on approximately 90 percent of intraregional trade were eliminated effective January 1, 1995. Tariffs on remaining sensitive sectors, such as chemicals, dairy products, steel, textiles, and some fruits and vegetables, are to be progressively reduced to zero by January 1, 1999 (for Argentina and Brazil) or 2000 (for Paraguay and Uruguay); automobiles and sugar, which proved difficult to negotiate, are excluded from the agreement until 2000. A common external tariff ranging between 0 and 20 percent applies to most imports from outside the region also beginning in 1995.

Led by Brazil, the MERCOSUR pact seeks to establish itself as a regional economic hub. Press reports have outlined MERCOSUR efforts to establish a South American Free Trade Area as a counterbalance to NAFTA. The Chilean economy would add little to the MERCOSUR's internal market, at least initially. Most interregional trade already occurs at preferential terms under the auspices of the Latin America

Integration Association (LAIA).<sup>2</sup> However, the addition of Chile to the group could add significant momentum for other Latin American countries to seek entry to MERCOSUR.

Discussions between Chile and MERCOSUR for a free-trade area began in September 1994 but stalled by mid-1995 because of several factors. The respective negotiators initially were unable to agree on a timetable for concluding the talks. Negotiators also encountered difficulties aligning Chile's more liberal trade regime with that of MERCOSUR. Moreover, Brazil has already sought derogations to the common external tariff and has sought to restrict the scope of the talks to eliminating barriers to trade in goods and to postpone talks on services until domestic and constitutional reforms are in place to allow Brazil to negotiate in those areas.

Chile-MERCOSUR negotiations also are complicated by the need to coordinate existing bilateral LAIA preferential trade regimes between Chile and each of the MERCOSUR countries into a single Chile-MERCOSUR agreement. (LAIA members accord preferential tariffs to one another through separate bilaterally negotiated agreements. Margins of preference are determined by relative levels of economic development. Argentina and Brazil are considered more developed countries and afford the greatest levels of tariff preference; Chile and Uruguay are intermediate developed countries; and Paraguay, a less developed country, affords the fewest preferences.) Chile's bilateral LAIA agreements are due to expire by the end of 1995, creating an incentive to draft a single Chile-MERCOSUR agreement before yearend.

At an August 21-22 meeting, Chilean and MERCOSUR negotiators agreed to establish working groups in four areas: market access for goods and commercial disciplines; technical and sanitary and phytosanitary standards; physical integration, transportation, and related services; and institutional issues. The working groups are scheduled to meet during September 1995. The overall negotiating goals set for the balance of 1995 include (1) the conversion of Chile's bilateral LAIA trade pacts into a single Chile-MERCOSUR pact; (2) establishment of a tariff-phaseout schedule for preferentially traded goods, items not covered under preferential pacts, import-sensitive products, and exceptions to the phaseout; and (3) the completion of framework agreements to set future negotiating deadlines in other areas.

<sup>2</sup> LAIA, also known by its Spanish acronym ALADI, is a multilateral preferential trade association comprising Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela.

MERCOSUR officials have expressed concern about the possible effects of Chilean accession to NAFTA. MERCOSUR is particularly concerned that NAFTA accession would be a significantly more comprehensive agreement than the proposed Chile-MERCOSUR free-trade agreement. For example, government procurement, intellectual property, and nonfinancial services, all included in NAFTA are not covered in MERCOSUR. Moreover, Chile's tariff regime would remain significantly out of alignment with the MERCOSUR standard. Chile undoubtedly will maintain its uniform 11-percent tariff on external trade while MERCOSUR maintains its tiered common external tariff scheme with duties as high as 20 percent.

## Outlook

The critical first step towards the FTAA will be the completion of negotiations for Chile's accession to NAFTA. Failure of the U.S. administration to receive fast-track negotiating authority by the March 1996 ministerial meeting could seriously delay FTAA plans and undermine the credibility of the U.S. commitment to hemispherewide free trade.

The June meeting of the hemisphere's trade ministers has added significant momentum to efforts to create the FTAA. Many unresolved issues remain concerning the exact content and the course of future FTAA negotiations. MERCOSUR's efforts to establish a southern axis of countries, with plans to bring Chile into the group by yearend, adds further significance to building a viable foundation for the FTAA in the next few months.

## Japan's Trade with Asia Up as Surplus Declines

During 1990-93, Japanese exports grew by 26.0 percent in dollar terms, compared with only 2.7 percent growth in the value of imports. However, in the past year and a half, Japan's import growth has outpaced that of exports. In April-June of 1995, Japan's imports increased by 32 percent over imports in the previous quarter, whereas exports grew by 21.5 percent. Import volume has also expanded more rapidly than export volume, with monthly import volume increases averaging 16 percent in the first 7 months of 1995. Export volume grew by 4.9 percent over the same period. Although imports have increased more than exports in percentage terms, a greater absolute value increase in exports has helped perpetuate the growing Japanese trade surplus.

The yen's appreciation has been the main cause of this recent shift in Japanese trade flows. The appreciation of the yen led to higher export prices (in

U.S. dollars) in the short run, and also an increase in the value and volume of imports. Over the long run, it is expected that Japanese export volume will decline because of decreased demand, and the value and volume of imports will continue to grow. The result will be a shrinking trade surplus.

The increase in Japanese imports over the past 1.5 years has been reinforced by a revival of consumer demand. More importantly, however, corporate demand for imports has expanded as Japanese manufacturers attempt to deflect the effects of the yen's appreciation by shifting production overseas and increasing imports. This has led in turn to Asia's increasing importance in Japanese trade and investment flows and a shift in the composition of Japan's trade.

### *Shift of Production Overseas*

Japanese companies tend to price their exports in U.S. dollars and avoid adjusting export prices to accommodate exchange-rate fluctuations. This reduces the effect of a higher yen on Japan's trade balance and also limits the decline in the demand for Japanese exports. Such an approach helps maintain the market share and overseas competitiveness of Japanese manufacturers, but also erodes profits whenever the yen appreciates significantly. As part of the effort to regain lost profits, Japanese firms, particularly in the manufacturing industry, have been slowly bringing down their breakeven exchange rates—the exchange rate at which a Japanese industry can remain profitable or at least break even. In a recent Nihon Keizai survey, Japanese manufacturers indicated that their average breakeven exchange rate was 94.98 yen, down from 1994's average of 110.4 yen. The companies surveyed identified two primary tools used to remain competitive—moving production overseas and increasing imports.

As a result, the overseas share of Japanese production—predicted prior to this spring's most recent bout of yen appreciation—was expected to climb from 16.1 percent in 1993 to 21.7 percent by 1997. When Japanese companies consider where they will locate production facilities, China and Southeast Asia are favorite destinations. According to surveys of Japanese businesses, of those planning to invest overseas, about 48 percent will be investing in China, and nearly 47 percent will invest in Southeast Asia. Only 4 percent will be investing in Europe, and 15 percent of those surveyed indicated they will invest in the United States. Some companies plan to invest in more than one location. For many companies, such as those in the automotive industry, China's lure is due to a low-cost labor force and a huge consumer market.

One indication of the increase in overseas production facilities is Japanese investment flows. Total Japanese foreign direct investment (FDI) increased by 14 percent, from \$36 billion in 1993 to \$41 billion in 1994. Of that, \$17.3 billion was directed toward the United States, which saw 1994 FDI from Japan increase by 17 percent over that in 1993. As the largest destination for Japanese foreign investment flows, the United States receives almost twice the amount invested in Asia.

Asia-bound investment flows increased by a substantial 46 percent, to a record \$9.7 billion, in 1994, accounting for nearly 24 percent of total Japanese FDI. China-bound investment increased by 52 percent, ranking China second to only the United States in terms of Japanese bilateral investment flows in 1994. Having increased by over 50 percent per year for the past 4 years, Japanese FDI in China reached \$2.6 billion in 1994. Investment in Indonesia rose by 116 percent, from \$813 billion in 1993 to \$1.8 billion in 1994. Other beneficiaries of increased Japanese FDI flows to Asia include Thailand, Malaysia, and the Philippines. Japanese investment in Latin America rose even faster than investment in Asia, from \$3.4 billion in 1993 to \$5.2 billion in 1994, or by 55 percent. Japanese investment flows to Europe fell by 22 percent.

Much of the increase in 1994 FDI was in manufacturing investment, which grew by 24 percent, from \$11.4 billion in 1993 to \$13.8 billion in 1994. Asia received the largest share of Japan's outbound manufacturing investment, \$5.2 billion of the \$13.8 billion total for 1994. China's share of Japanese manufacturing investment has increased considerably, partly reflecting the establishment of new production bases. Japanese manufacturing investment flows to Southeast Asia went primarily to the expansion of existing facilities. Although the United States received the largest share of Japanese FDI in 1994, only \$4.8 billion of Japan's outbound manufacturing investment went to the United States—27 percent of total U.S.-bound flows. The largest share of Japanese investment flows to the United States was in real estate and services.

Electronics was the largest area of investment in Asia for 1994, followed by chemicals, textiles, and iron and steel. By 1998, it is predicted that nearly 40 percent of the production of Japan's five major electrical groups will be offshore, which will lead to a shift in the sales of electrical goods in Japan. For example, 25 percent of televisions sold in Japan were imported in 1992. By February 1995 that percentage had increased to 83 percent. Most of the imported televisions were made by Japanese companies in overseas facilities and then imported by them for sale in the domestic market.

Investment and trade flows are very closely connected, particularly if the investment is directed toward overseas production facilities that serve as an extension of Japanese companies. As of 1994, 9 out of Japan's 10 top trading partners were located in the Asia-Pacific region (table 9). China, with total trade of \$46 billion in 1994, held only a 7-percent share of Japan's trade, far below that of the United States. Yet for China, this is a strong showing over 1990, when China's trade with Japan totaled only \$18 billion. Hong Kong, Singapore, Thailand, and Malaysia have improved their rankings primarily because of increased imports from Japan. Over the 4-year period, the percentage increase in the dollar value of Japanese exports ranged from Thailand's 61-percent increase to Malaysia's 124-percent increase. Korea and Taiwan maintained their rankings, primarily because of lower growth rates than the other Asian economies, yet Japanese imports from both countries grew significantly. The rapid growth in Japan's exports to Asia, which has outpaced growth in trade with other countries, reflects continued strong economic growth in Asia and a shift of Japanese production to Southeast Asia and China.

**Table 9**  
Japan's top 10 trading partners based on total trade value, 1990 and 1994

Ranking	1990	1994
1 .....	United States	United States
2 .....	Germany	China
3 .....	Korea	Korea
4 .....	Taiwan	Taiwan
5 .....	—	Germany
6 .....	China	Hong Kong
7 .....	Indonesia	Singapore
8 .....	United Kingdom	Thailand
9 .....	Canada	Australia
10 .....	Hong Kong	Malaysia

Source: International Monetary Fund, *International Financial Statistics*, August 1995.

The United States, with bilateral trade with Japan totaling \$181.8 billion in 1994, far surpasses other trading partners and holds a 27-percent share of Japan's total trade. Australia, Indonesia, the United Kingdom, and Canada have seen a decline in importance as Japan's trading partners over the 4-year period. Even though the value of their total trade with Japan increased, it has grown far less rapidly than trade with most of the ranked Asian economies. Canada was one of two countries to register a decline in the value of its imports from Japan. Germany has become a less important trading partner for Japan and the value of both its imports from and exports to Japan declined over the 4-year period. Economic recovery in Europe, however, should boost Japan's trade, particularly

Japanese exports, with countries in that region in the future.

The move of production offshore, specifically to Asia, has produced not only an expansion of Japan's imports from that region, but a shift in the product composition of Japan's exports and imports.

## Trade Shifts

### Exports

The United States, with imports from Japan totaling \$118.7 billion in 1994, has a huge lead over competing countries as Japan's largest export market (table 10). For example, Japan's exports to Hong Kong, \$25.7 billion in 1994, are only 22 percent the value of Japanese exports to the United States. The United Kingdom, where Japan registered only a 17 percent increase in exports, and Germany, where Japanese exports fell by 1.0 percent, became less important export markets.

The four newly industrialized economies (NIEs)—Korea, Hong Kong, Singapore, and Taiwan—became the most important Japanese export markets after the United States. China is also one of Japan's most important and fastest growing export destinations. As a result of the strong growth in Japan's exports to these and other Asian countries, Asia is now the most important regional destination for Japanese exports (table 11). The 8.4 percent climb in Asia's share of Japan's exports is due to a combination of increased exports to Asia and minimal growth in the value of exports to all other regions. The United States lost nearly 2 percentage points in its share of Japan's exports over the 4-year period.

Capital goods, including primarily office machine parts, automobile parts, integrated circuits, semiconductors, and chemicals, now make up over 60 percent of Japanese exports. Many of these goods are

**Table 10**  
Top 10 destinations for Japanese exports based on export value, 1990 and 1994

Ranking	1990	1994
1 .....	United States	United States
2 .....	Germany	Hong Kong
3 .....	Korea	Korea
4 .....	Taiwan	Taiwan
5 .....	Hong Kong	Singapore
6 .....	United Kingdom	China
7 .....	Singapore	Germany
8 .....	Thailand	Thailand
9 .....	Australia	United Kingdom
10 .....	Canada	Malaysia

Source: International Monetary Fund, *International Financial Statistics*, August 1995.

**Table 11**  
Partners' shares of Japan's exports based on export value, 1990 and 1994  
(Percent)

Region/country	1990	1994
Asia	34.2	42.6
ASEAN	11.5	15.2
China	2.1	4.7
Korea	6.1	6.1
Taiwan	5.4	6.0
Western Hemisphere	37.4	36.0
United States	31.5	29.7
Canada	2.4	1.5
Europe	23.4	17.1
Middle East	3.0	2.5
Africa	2.1	1.8
Total	100.0	100.0

Source: Japan Tariff Association, *Japan Exports & Imports: Commodity by Country*, Dec. 1990, pp. 1-2; Japan Tariff Association, *Japan Exports & Imports: Commodity by Country*, Dec. 1994, pp. 1-2.

destined for factories in Southeast Asia and reflect the shift of Japanese production overseas. In the first 11 months of 1994, Japan's exports of capital goods increased by 13 percent over those in the corresponding period of 1993. Consumer durables exports declined by 4.8 percent, exports of electrical appliances dropped by 5.8 percent, and passenger car exports declined by 5.3 percent. Both capital goods and consumer goods still show large absolute export gains even though the share of capital goods is increasing at a faster pace.

## Imports

The dollar value of Japan's imports rose by 16.5 percent during 1990-94. Imports from Asia, particularly China, the NIEs, and Southeast Asian countries, grew at a faster pace than imports from other regions. Japanese imports from China jumped from \$12.1 billion to \$27.6 billion, or by 128.7 percent, and both Thailand and Malaysia saw strong increases in the value of their exports to Japan. Asia is the greatest regional source of Japanese imports, as shown in table 12. The value of Japan's imports from Latin and South America, as well as Europe, the Middle East, and Africa, declined over the 4-year period, contributing to Asia's increasing importance as a source of Japanese imports. Japan's imports from the United States increased in dollar value by 19.4 percent over the 1990-94 period, slightly greater than the overall increase in Japanese imports of 16.5 percent. Japan's imports from other industrialized countries grew modestly.

Although Asia's growing importance as a regional supplier of Japanese imports has not been as obvious as for exports, its share of Japan's total import value

**Table 12**  
Partners' shares of Japan's imports based on import value 1990 and 1994  
(Percent)

Region/country	1990	1994
Asia	35.1	41.5
ASEAN	12.4	13.8
China	5.1	10.0
Korea	5.0	4.9
Taiwan	3.6	3.9
Western Hemisphere	30.3	29.6
United States	2.4	22.9
Canada	3.6	3.2
Europe	19.9	17.2
Middle East	13.0	10.2
Africa	1.7	1.5
Total	100.0	100.0

Source: Japan Tariff Association, *Japan Exports & Imports: Commodity by Country*, Dec. 1990, pp. 3-4; Japan Tariff Association, *Japan Exports & Imports: Commodity by Country*, Dec. 1994, pp. 3-4.

increased by 6.4 percentage points during 1990-94. This was mostly due to a significant increase in the value of imports from China, which boosted China's share of the Japanese import market by nearly 100 percent, from 5.1 to 10.0 percent. The value of Japan's imports from the European Union and the Middle East declined, and their share of Japanese imports fell by 2.7 and 2.8 percentage points, respectively. The United States remains Japan's leading source of imports, with China in second place as of 1994.

In the 1st quarter of 1995, the dollar value of Japan's imports from China increased by 37.4 percent over the value of the corresponding period of 1994. This was nearly 3 times the increase in the value of imports from the United States. The value of imports from the NIEs increased by over 30 percent, and Southeast Asian countries saw an increase of 24.1 percent over the same period. In terms of volume, imports from the United States were steady, whereas imports from Asia increased by 16.3 percent.

Consumer and corporate demand in Japan for lower priced durable and intermediate goods has pushed imports up in the past year, particularly imports of foreign-made clothing, automobiles, semiconductors, and other consumer products. The volume of reverse imports, products built overseas and imported into Japan for sale on the domestic market, is also increasing. The top imported items for 1994 included oil, lumber, computer and office equipment, semiconductors and electronic devices, automobiles, clothing, liquid methane gas, organic compounds, and coal. Imports of manufactured goods, especially passenger cars, computers and components, and integrated circuits, continued to rise rapidly in the first quarter of 1995.

## Conclusion

Japan's July current account surplus dropped by 20.5 percent from that of a year ago to \$9.22 billion—a significant drop—after having fallen by 1.8 percent in June. The July trade surplus decreased by 15.6 percent, to \$12.12 billion, with exports gaining 9.7 percent and imports increasing by 28.9 percent. In volume terms, exports dropped by 0.3 percent and imports increased by 16.6 percent. The "J-curve" effect seems to have run its course as the drop in export volume offsets the increase in export prices. Imports have continued to grow in terms of both volume and value. The trade surplus is finally declining as a result of the exchange-rate fluctuations.

Other variables will continue contributing to shifts in Japanese trade flows and composition. Japanese corporations, pressed to improve their competitiveness and adaptability to exchange rate fluctuations, invested in overseas production facilities, many in Asia. Imports of manufactured goods continue to increase, and their share of total imports has also climbed. In July, the ratio of manufactured imports to total imports reached 58.9 percent. These effects on Japanese trade flows will continue and will offset the effects of exchange-rate fluctuations on imports and exports.

## Trade With Vietnam Off to a Healthy Start

In the nearly year-and-a-half since the end of the U.S. embargo on trade with Vietnam, trade between the two one-time enemies is off to a healthy start. The lifting of the trade embargo in February 1994 was the first of three recent major developments in U.S.-Vietnamese relations. On July 11, 1995, President Clinton extended diplomatic recognition to Vietnam, and on July 24, 1995, Commerce Secretary Ron Brown announced a "significant expansion of the Big Emerging Markets Initiative" to encompass all of the Association of Southeast Asian Nations (ASEAN). Vietnam, as a recent addition to ASEAN, will also benefit.

Prior to the lifting of the embargo, there were no U.S. imports from Vietnam, and U.S. exports (Communist related) averaged \$367,500 per month in the 14 months prior to March 1994. The first imports from Vietnam were registered in March 1994 and averaged over \$9 million dollars per month from March 1994 through July 1995. Imports were especially strong in the first quarter of 1995, with a monthly average of just over \$21 million. Exports averaged over \$17 million per month from March 1994 to July 1995, or almost \$12 million per month if a large sale of airplanes in October 1994 is excluded. Since

March 1994, the trends for both imports and exports have been positive, albeit irregular (table 13).

U.S. exports to Vietnam have been diverse, but fertilizers and cotton have consistently been the top export items, with the exception of the airplane sales mentioned above. These two items together accounted for 18 percent of U.S. exports to Vietnam in 1994 and 21 percent in the first half of 1995 (table 14). U.S. imports from Vietnam have been dominated by coffee. Coffee constituted 62 percent of imports in calendar year 1994 and 78 percent in the first half of 1995 (table 15). Coffee is notable for being free from U.S. duties under both columns 1 and 2 of the *Harmonized Tariff Schedule of the United States (HTS)*. Vietnam is subject to column 2 duty rates, which are, in general, the full rates that were established by the Tariff Act of 1930 (popularly known as the Hawley-Smoot Act), which in most cases are much higher than the column 1 rates. Column 2 duty rates applied in the recent past to Communist countries and are now applied only to Afghanistan, Cambodia, Cuba, Laos, and North Korea.

**Table 13**  
U.S. trade with Vietnam, by months,  
January 1993–June 1995

(1,000 dollars)

Period	Imports	Exports
1993:		
January	-	125
February	-	110
March	-	505
April	-	1,000
May	-	224
June	-	193
July	-	275
August	-	177
September	-	184
October	-	2,423
November	-	396
December	-	659
1994:		
January	-	451
February	-	592
March	2,512	1,951
April	2,953	8,195
May	3,409	6,412
June	3,645	9,732
July	2,697	6,375
August	8,212	16,983
September	10,814	12,433
October	4,085	78,619
November	5,138	11,759
December	8,057	15,706
1995:		
January	17,602	16,899
February	21,852	7,123
March	24,121	12,883
April	10,590	21,271
May	7,124	11,344
June	8,299	20,889
July	13,982	30,754

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table 14

Leading Items exported to Vietnam, by Schedule B subheadings, Jan.-June 1995, Apr.-June 1994, and Apr.-June 1993

(1,000 dollars)

Schedule B Subheading	Description	Jan.- June 1995	Apr.-June—	
			1994	1993
5100.00	Fertilizers	13,607	3,013	4,202
5201.00	Cotton, not carded or combed	5,248	5,883	2,844
5403.90	Machine tools for working metal, sintered metal carbides or cermets without removing material, steel			
5703.23	Passenger motor vehicles with spark-ignition internal-combustion reciprocating piston engine, over 1,500 but n/o 3,000 cc	4,635	-	4,635
5503.20	Synthetic staple fibers, not carded, combed or otherwise processed for spinning, or polyesters	3,388	722	2,911
	Total	30,174	11,679	16,639
	Total, U.S. exports to Vietnam	30,129	26,338	53,484

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table 15

Leading Items imported from Vietnam, by HTS subheadings, Jan.-June 1995, Apr.-June 1994, and Apr.-June 1993

(1,000 dollars)

HTS Subheading	Description	Jan.- June 1995	Apr.-June—	
			1994	1993
0901.11	Coffee, not roasted, not decaffeinated	67,198	7,388	15,601
0906.13	Shrimps and prawns, frozen	4,342	626	2,494
0216.00	Gloves, mittens and mitts, not knitted or crocheted	3,798	-	2,053
0901.12	Coffee, not roasted, decaffeinated	2,775	25	1,177
6205.20	Men's or boys' shirts, not knitted or crocheted, or cotton	1,569	291	909
	Total	79,655	8,330	22,234
	Total, U.S. imports from Vietnam	80,000	10,000	26,114

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the U.S. Department of Commerce.

in addition to Vietnam. Lower column 1 duty rates apply to countries with most-favored-nation (MFN) status, that is, all countries other than those mentioned above, with the exception of free-trade agreement partners (Canada, Mexico, and Israel) and certain developing countries that are granted trade preferences unilaterally by the United States (i.e., countries covered by the Generalized System of Preferences (GSP), the Caribbean Basin Economic Recovery Act, and the Andean Trade Preference Act).

On August 5, 1995, Secretary of State Warren Christopher opened the new U.S. Embassy in Hanoi as part of U.S. diplomatic recognition of Vietnam. While there, Vietnamese officials pressed Secretary

Christopher for a number of measures to facilitate economic relations between the two countries, including MFN status. The lack of MFN status is an impediment to U.S.-Vietnamese trade. Other items discussed by the officials include designation as a GSP beneficiary country and agreements on trade, aviation, taxes, shipping, and investment. Negotiations on a comprehensive U.S.-Vietnamese trade agreement are expected to begin in early November. The United States is planning to send an interagency delegation—including United States Trade Representative Mickey Kantor—to Hanoi to start the talks. MFN status could be granted only after the successful completion of such a trade agreement and is subject to a number of

conditions given Vietnam's status as a nonmarket economy under U.S. law. For these reasons, Vietnam is not expected to get MFN status in the near future.

Vietnam became a member of ASEAN<sup>3</sup> on July 28, 1995. As such, Vietnam has been included in the U.S. Commerce Department's Big Emerging Markets (BEM) Initiative. The 2 year-old BEM<sup>4</sup> Initiative is at the center of the Clinton Administration's National Export Strategy. The administration has identified 10 markets in which it feels that business opportunities are especially good for U.S. companies, and it claims to have launched an aggressive campaign to enhance commercial opportunities in these markets. Indonesia was originally the only ASEAN nation included in the BEMs, but all of ASEAN has recently been included.

Future data on U.S. trade with Vietnam can be obtained from the USITC publication *Trade Between the United States and China, the Successor States to the Former Soviet Union, and Other Title IV Countries*, published quarterly and available on the ITC Internet server at <http://www.usitc.gov> and <ftp://ftp.usitc.gov>. The report also is available on the Department of Commerce National Trade Data Bank. Printed copies may be obtained by calling 202-205-1809.

## India: Implementing Economic Reforms When Federal and State Interests Diverge

On August 8, 1995, the chief minister of the Indian State of Maharashtra announced that he would cancel a \$2.8 billion power generation project backed primarily by Texas-based Enron Power Development Corp. The project, already under construction, was to build a 2,015-megawatt (MW) power station in the Indian city of Dabhol.

India desperately needs additional power generation capacity to fuel future economic growth. India also needs massive infusions of foreign investment. This article uses the Dabhol project as a case study of India's efforts to maintain the momentum of economic reform when Federal and State government interests diverge.

<sup>3</sup> The seven member nations of ASEAN are Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

<sup>4</sup> The ten BEMs are the Chinese Economic Area (China, Hong Kong, and Taiwan), India, ASEAN, South Korea, Mexico, Brazil, Argentina, South Africa, Poland, and Turkey.

## Background

Prime Minister P.V. Narasimha Rao launched a major economic reform program in India in July 1991 shortly after his Congress Party won national elections. At that time, India was a relatively closed economy with significant barriers to trade and investment, with widespread government regulation, and tight controls on the private sector. Confronted by unsustainable fiscal and trade imbalances and rising rates of inflation and unemployment, Prime Minister Rao sought to fundamentally reorient the Indian economy.

Under his economic reforms, Prime Minister Rao cut tariffs, devalued the exchange rate, and eliminated most exchange controls. A "New Industrial Policy" announced in July 1991 dramatically relaxed restrictions on foreign investment, plant location and capacity expansion, and abolished local sourcing requirements. India's central bank set up a "single window" for virtually automatic approval of foreign investments up to 51 percent of equity in 35 industries that cover the bulk of manufacturing in India. (Projects outside the bank's guidelines are referred to the Foreign Investment Promotion Board for approval, which is generally given. Large projects of over \$100 million or projects that pose sensitive policy issues may be referred to an interministerial committee.) It is hoped that these economic reforms will help India begin to address many longstanding social and economic problems.

Since independence in 1947, India's high rate of population growth has been accompanied by disappointing economic performance. Today, India has a population of about 900 million individuals, and that figure is projected to reach 1 billion by the year 2000. At current population growth rates, India could overtake China as the world's most populous country during the next century. Nearly one-fourth of the labor force is officially unemployed. Per capita gross domestic product in India is \$310 lower than that of any country in the Western Hemisphere. Less than one-half of the population is literate. Inadequate economic infrastructure is a chronic problem. According to recent estimates, only 14 percent of India's population has access to clean water and modern sewage facilities—one of the lowest rates in the world.

Inufficient electric power detracts significantly from India's economic growth potential. According to several reports, India must double its present installed capacity of more than 30,000 MW over the next decade if it is to meet demand, which is growing by an estimated 9 percent annually. The problem of insufficient power generation is compounded by technological inefficiencies and systemic problems. One source estimates that 22 percent of India's

electrical power is lost through transmission and distribution because of both poor equipment and illegal tapping into power lines. Beginning in 1991, the Government of India invited foreign investors to negotiate deals to design and construct power projects on a fast-track basis. These projects were cleared by the Federal Government on a priority basis, without competitive bidding, in an effort to address the country's increasing energy shortfall.

## The Project

Maharashtra, India's main industrial State, is home to more than one-half of the largest 100 multinational companies operating in the country—including Coca Cola, Kellogg, and Procter & Gamble. In addition to Bombay, India's largest city, Maharashtra has numerous large industrial centers and is home to clusters of industries in such sectors as textiles, automobiles, engineering, food processing, and petrochemicals. Despite these endowments, Maharashtra embodies the many challenges facing modern India, including the country's energy shortages. Although Maharashtra is the least power deficit State in India, the Indian Power Ministry recently estimated that the State was as much as 18 percent short of energy. Indeed, Maharashtra has suffered three major blackouts so far during 1995, the most recent of which, in July, left all of Bombay without electricity for four hours.

Dabhol, situated 120 miles south of Bombay, is located on the west coast of India on the Arabian Sea. The Government of India formally approved the Dabhol power generation project in February 1993. The project was designed in two phases. The first phase called for the construction of a 695-MW oil-fired power plant. The second phase called for a 1,320-MW expansion of the plant's output that also would convert the plant to run on liquefied natural gas. U.S.-based Enron Power Development Corp. had an 80-percent stake in the project. An additional 10-percent backing came from each of two other U.S. companies, Bechtel Enterprises Inc. and General Electric's GE Capital Corp. The total cost of the project, \$2.8 billion, made it the largest single foreign investment project in India in recent years.

The Indian constitution divides responsibility for the electricity sector between the Federal Government and the States. While the Federal Government manages the investment approval process and sets the States' funding levels, India's States control the actual construction and operation of the power facilities. India's money-losing State electricity boards (SEBs), whose cumulative operating losses total more than \$9 billion, control electricity transmission and distribution

as well as the collection of revenue from end-users. Following Federal Government approval, the Dabhol project was submitted for negotiation with the State of Maharashtra.

Enron negotiated the project with the Maharashtra State Government led by Prime Minister Rao's then-ruling Congress Party. The Dabhol project was controversial from the beginning because of Enron's request for Government guarantees of payment. Enron sought, and eventually obtained, a 12-year "counter guarantee" from the Government of India. Under this mechanism, Enron received the first right of payment from the Maharashtra SEB; payments by the SEB were guaranteed by the State of Maharashtra. The Federal Government of India, in turn, guaranteed that the State will make the SEB's payments in event of default through the Federal Government's control over States' funds held at India's central bank. Several environmental challenges were made to the Dabhol project, but they ultimately were dismissed in Indian courts. (There is still lingering resentment in India of the 1984 gas leak at a Union Carbide Corp. plant that killed thousands near the city of Bhopal.) In a complex final arrangement, Enron agreed to reduce its 80-percent stake to below 50 percent by transferring shares to the Maharashtra SEB and other investors. In return, the Maharashtra SEB agreed to purchase electricity from the Dabhol plant for 20 years at a predetermined price. Enron secured loans for the Dabhol project in March 1995 and commenced preliminary construction for phase one.

## Second Thoughts

In Maharashtra's March 1995 Statewide election, Prime Minister Rao's ruling Congress Party was defeated by a Hindu-based nationalist coalition led by the Bharatiya Janata Party (BJP). Upon entering office, BJP officials set up a committee to review the Dabhol project, which ultimately recommended the project be canceled. On August 3, 1995, the chief minister of Maharashtra State formally announced that his cabinet had canceled the second phase of the Dabhol project and repudiated the first phase contract already in force (even though Enron had broken ground).

Maharashtra's new leadership condemned the Dabhol project on several grounds. The project was called too expensive because once on line, it would sell electricity to the Maharashtra SEB at a price higher than that the SEB currently charges its customers. Project supporters contend that this indictment is unfair because future utility rates inevitably are more expensive than present rates. Maharashtra State officials also cited environmental concerns (even though environmental complaints were dismissed in prior legal filings), indicated the possibility, though

unsubstantiated, of corruption (because the fast-track approval process used was not open to competitive bidding), and said that the agreement was one-sided in favor of Enron Corp. Under terms of the contract, Maharashtra had the right to renegotiate or cancel the contract, subject to payment of compensation to Enron.

According to separate background information provided by the U.S. Consulate in Bombay, opposition to the Dabhol project also reflected local political concerns of India's caste society. The Consulate reported that certain upper castes opposed the Dabhol project because it stood to create significant economic opportunities for lower castes (Enron's primary labor pool) in the region and thus threatened to undermine the existing regional social and political power structure.

Shortly after Maharashtra announced cancellation of the contract, Enron initiated legal proceedings for damages against the Maharashtra SEB (the contract provides for such arbitration to be conducted in London) and halted all construction. An arbitration panel, made up of U.S. and Maharashtra representatives as well as a neutral third party, was scheduled to meet October 17, 1995. At the same time, Enron representatives sought a compromise agreement with Maharashtra officials. Having already committed some \$300 million for work on phase one, Enron asserted that it was too far along in construction to amend the terms of that part of the agreement. But by late August, Enron stated that it was prepared to revise disputed portions of its contract with Maharashtra for the more extensive second phase, including the controversial pricing arrangement.

The dispute reached a new level by September when the State of Maharashtra filed suit in Bombay claiming that the London arbitration panel would be unnecessary because the contract with Enron technically had not been breached. (Sources contacted by the U.S. Consulate in Bombay report that Maharashtra's arbitration case is weak.) Moreover, Maharashtra sought to cancel contracts that might require it to pay compensation to Enron for killing the deal. (Interest payments Maharashtra must pay in penalty on a likely damage award made to Enron are estimated to be \$250,000 daily during the time work has been suspended, according to one source.) All of Enron's investment, including lost profit, is covered under the existing investment guarantees. The Government of India ultimately shoulders the burden of liability for the Dabhol project. However, Enron officials reportedly have refrained from seeking intervention by India's Federal Government for fear of further inflaming this difficult situation.

On September 22, Enron formally offered to renegotiate the Dabhol project. According to press

reports, Enron proposed a downward revision in the electricity rate comparable to the tariffs of similar projects. Enron also offered, should competitive bidding be required, to match the tariff of the best competitively bid tariff by similar recently approved new power projects. Enron offered to further trim costs by providing a 30 percent equity holding to an Indian partner. In late September, after examining Enron's proposed terms of renegotiation, the Maharashtra State government formally announced its willingness to begin discussions to "revive" the Dabhol project. The two sides agreed that renegotiation talks would occur in Bombay, but fixed no date. Maharashtra had requested that Enron postpone the London arbitration proceedings by at least one month, and offered to delay its own legal case in Maharashtra court, but as of this writing neither of the legal cases has been postponed.

The first meeting of the London arbitration panel occurred on October 17, 1995, and future meetings are anticipated to occur over the next several months. The U.S. Consulate in Bombay reports that the contract renegotiation talks are pending the appointment of a negotiating team to represent the State of Maharashtra.

### *Investment impact*

Actions by the State of Maharashtra have brought the fast-track program and efforts to improve India's energy infrastructure to a virtual standstill. The Maharashtra SEB is delaying further action on an agreement for a British, French, and Japanese consortium to construct a 1,084-MW coal-fired power plant in the city of Bhadravati. That project also had been approved by the former Maharashtra State administration without competitive bidding. One other Federally approved fast-track power generation project, valued at \$643 million, for U.S.-based AES Transpower to construct a 420-MW thermal plant in India's eastern State of Orissa, also is under review by that State's newly-elected government. AES, which already has secured Federal guarantees, reportedly offered to rework its contract with the state after Enron's project in Dabhol was canceled. An additional six ventures are in the fast-track pipeline; reportedly, the investors for some of these planned projects have delayed further negotiations pending a resolution of Enron's situation.

Prior to Maharashtra's reversal of Enron's power generation project in Dabhol, India appeared headed for another banner year for foreign investment. Approved foreign investment in India rose sharply from \$201 million in 1991 to an estimated \$3.4 billion in 1994; foreign investment actually increased from \$134 million in 1991 to over \$700 million in 1994. Before Maharashtra's announcement canceling the Dabhol project, several foreign banks reportedly

notified the Government of India that repudiation of Enron's contract would jeopardize India's prospects for obtaining project financing in the future. Indeed, British and French leaders for the planned power plant at Bhadravati reportedly are reviewing their originally-proposed terms of credit in view of India's now-higher credit risk rating.

According to one source, India's energy infrastructure alone needs investments of \$175 billion to meet the country's electric power needs over the next 12 years. The ramifications are widespread. Already Maharashtra's effort to cancel the Dabhol project is being cited widely as contributing to the difficulties facing other developing countries in obtaining private capital financing.

### *Outlook*

Maharashtra's move to scrap the Dabhol power project shows that populist opposition to foreign investment remains present in India. Delays in bringing on-line additional power generation capacity may make India's economy the biggest loser in this situation. The biggest danger is that this action could add to foreign investors' concerns that India has not fully turned away from economic nationalism and hostility to private business and foreign investment. The U.S. Embassy in New Delhi reports that these concerns are still prevalent, albeit less so than in the recent past. (Reinforcing these present-day concerns, on September 13, 1995, the first Kentucky Fried Chicken (KFC) restaurant in India was ordered shut in the city of Bangalore allegedly because a seasoning used contains a level of monosodium glutamate in excess of that allowed in India. Charges also attacked KFC as a baneful influence on Indian society. A judge in Bangalore allowed the restaurant to remain open pending legal appeals.)

Maharashtra's efforts to cancel the Dabhol project also reveal the weaknesses of India's fast-track program for power generation projects. The most damaging claim made by the new Maharashtra Government is that because negotiations occurred in the absence of competitive bidding, India will pay too much for the power it needs. Opponents of the project say that Enron's willingness to renegotiate phase two of the project is evidence that the investors were given too-favorable a deal. India's central bank has since determined that future power generation contracts will be open to competitive bids and related procedures will be conducted in a more transparent manner.

Although the case remains in arbitration as of this writing, Maharashtra's efforts to reverse the Dabhol project also point to the significance of the distribution of Federal-State power in India's economic reform and

growth programs. In sectors where decisionmaking and responsibility are shared between politically charged Federal and State Governments, this case draws attention to the fact that commitments undertaken by India's Federal Government can be easily overruled by the States. As litigation costs for the State of Maharashtra mount in the face of a potentially costly arbitration loss, equally important to a solution between Maharashtra and Enron is an agreement that will allow the opposing political parties to save face.

### **Cooperation Among International Economic Institutions**

#### *Industrial Globalization and Future Economic Challenges*

At the June 1995 economic summit in Halifax, Canada, the leaders of the seven (G-7) main industrial democracies—Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States—pledged to continue to work together, and with other economic partners, to promote the economic growth needed to create good quality employment and improve the well-being of their people. In their June 1995 communiqué, the G-7 leaders also reiterated their intention to review the international economic institutions to ensure that these bodies "are equipped to deal effectively with the challenges of the future." These challenges stem from the vast technological change that has occurred in the world economy over the past 50 years. That change has promoted globalization of production and made economic interdependence between countries much more salient in recent years than in the past.

#### *Current Financial Challenges and Responses*

The growth and integration of world capital markets are an area where the international community shares a common interest. With the accelerating pace of financial innovation driving this increased interdependence, not only are the benefits derived from this process evident to world leaders but also its inherent risks. In this light, the review of international financial institutions undertaken at Halifax examined the need for change in the architecture of the Bretton Woods financial institutions—the International Monetary Fund (IMF) and the World Bank group—as well as the regional development banks. The latter category comprises institutions such as the African

Development Fund, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank.

The sudden financial crisis in Mexico that developed in late 1994 and early 1995 brought the need for such a review into sharp focus. With the view that prevention of similar crises in the future was preferable to coping with them once they arose, the G-7 leaders agreed at the Halifax summit on a package of measures designed to head off such disruptions. These measures will include:

- the timely monitoring and publication of key economic and financial data;
- the establishment of benchmarks for such data along with the identification of countries that comply with it;
- sharper policy advice to governments that do not comply and appear to be avoiding needed action; and finally
- establishment of a new standing procedure, the Emergency Financing Mechanism, that effectively doubles the line of credit available to the IMF from the countries that are signatories of the 1962 General Arrangements to Borrow (GAB).

Many of the issues announced at the Halifax summit regarding strengthened IMF surveillance and adequate resources were further discussed at the IMF-World Bank annual meeting, held in Washington DC on October 6-8, 1995. There, the leading industrial nations that furnish resources to the IMF through the GAB agreed on a plan that will provide the IMF with an additional \$26 billion to cope with any future Mexico-like financial crisis. The IMF already has the ability to draw on \$26 billion through the GAB, but the new facility sets up a parallel arrangement of equal size on which the IMF may draw in the event of a financial crisis that might seriously damage the international financial system.

## *Other Common Goals of the International Community*

The leaders went on to review the thrust of policy in other areas of common interest. One primary objective of international cooperation set out in their communiqué is to promote "sustainable development—based on the fundamentals of democracy, human rights, accountable government, investment in human resources, and environmental protection. The International Development Agency (IDA) of the World Bank group is to play a lead role in this regard, taking into account the policy advice given by the United Nations as well as by the IMF and the World Bank.

A second related objective set by the G-7 leaders is the reduction of persistent extreme poverty. At the Naples summit in 1994, the leaders encouraged the Paris Club—the 11 countries providing through the GAB the bulk of the loanable resources to the IMF—to improve the debt terms of the world's poorest countries, particularly those in sub-Saharan Africa. This year at the Halifax summit, the leaders focused on encouraging the Bretton Woods institutions to develop a comprehensive lending approach that would help such countries via a more flexible use of existing policy tools.

Protecting the environment by upholding commitments made at the United Nations Conference on Environment and Development (UNCED) held in 1992—dubbed the Earth summit—as well as reducing the disruption to economic development and social stability caused by disasters and other crises—particularly those involving human rights and refugee dimensions—were also areas for common action identified at the summit.

## *Greater Coherence in Global Economic Policymaking*

Lastly, the G-7 leaders sought to reinforce the "coherence, effectiveness and efficiency of institutions" in dealing with future challenges. Reducing administrative or other overlap between the international financial institutions is one important means to this end. The leaders will aim to have the IMF and the World Bank concentrate more on their core areas—macroeconomic policy for the IMF, structural and sector policy for the World Bank—including having the World Bank and the regional development banks decentralize operations where possible. The World Bank group will aim to better integrate its affiliates such as the International Finance Corporation and the Multilateral Investment Guarantee Agency into its country assistance strategies, and the regional banks will aim to better integrate individual country donors into their aid plans.

The G-7 leaders will seek to have the UN, in a reform process currently underway, ensure a better internal coordination of policy with the Economic and Social Council (ECOSOC). They will also seek to update the mandates of U.N. entities such as the U.N. Commission for Trade and Development (UNCTAD) and the U.N. Industrial Development Organization (UNIDO) to avoid duplication or overlap. UNCTAD, for example, boasts one of the broadest memberships (all 180-plus United Nations members, as well as other entities) in its aim to promote international trade, whereas UNIDO promotes industrial development among roughly the same membership.

The leaders urged improved coordination with other international organizations which, although not specified, will surely include the World Trade Organization (WTO) and the Organization for Economic Co-operation and Development (OECD). The WTO, as the organization succeeding the General Agreement on Tariffs and Trade (GATT), oversees the operation of the Uruguay Round Agreements and provides the multilateral framework for conducting international trade among its 100-plus members. The OECD focuses on economic policy issues common to the world's 25 industrialized countries that make up the OECD membership.

## *Creating Opportunities Through Open Markets*

The creation of the WTO in 1995 provides a fundamental means by which the international community can further support increased trade and new investment. Having sought to strengthen the multilateral framework covering world trade in the 45 years since World War II, policymakers took the opportunity when drafting the Uruguay Round Agreements (URA) to also mention explicitly the broader economic policy context in which the URA and the WTO would be set. The drafters recognized in the URA "Declaration on the contribution of the World Trade Organization to achieving greater coherence in global economic policy making," that stability promotes sustainable growth, economic development, and trade expansion, as well as the correction of external imbalances. The role foreseen by the international community for the WTO is to act as (1) a forum for further trade liberalization (2) a monitor for trade and economic policies that help underpin global economic well-being; and (3) a focal point for enforcing observance of these world trade rules.

However, in accepting the EU proposal in the Round for a decision on greater coherence in economic policy making, governments recognized that in carrying out its trade mission, the WTO would also reinforce the missions of the other multilateral economic institutions. The combined effect would be to promote the underlying economic and financial conditions that ultimately support exchange-rate stability—a topic of longstanding interest to the EU. The G-7 leaders pledged to work to consolidate the WTO as an effective institution that will help create opportunities for growth and employment by opening national markets to trade. The G-7 leadership recognized that the ability of both domestic and foreign producers to supply goods and services through world trade channels may depend as much on domestic policies as on foreign trade barriers and committed to

work to reduce barriers to both. The leaders recognized the need and reaffirmed their commitment to make the WTO dispute-settlement mechanism function smoothly. However, setting a new dispute mechanism in place that reverses previous procedure (now consensus is required to reject panel findings) and creates a new appellate body has not been without its difficulties. Recently, for example, the United States and the EU were each seeking to appoint two members of the seven-member appellate body because of the importance of their economies in world trade.

The G-7 leaders endorsed closer cooperation between the WTO and other international economic institutions. But despite calls for close liaison between the WTO and the IMF and World Bank, this cooperation is likely to remain constrained for the foreseeable future by the stipulation in the URA declaration that such cooperation must not impose any additional conditionality or cross-conditionality on government, that is not already called for by the Bretton Woods institutions. Such conditionality falls largely within the domain of the IMF in carrying out surveillance of members' economies and its role in helping avert or resolve financial crises such as in Mexico.

While conditionality typically focuses on IMF approval of loan packages to a government on the condition that it succeed in reaching its macroeconomic targets set for policies involving items like budget revenues and expenditures or credit creation and inflation, such targets can also involve trade policies that would fall within the purview of the WTO, such as reducing imports and boosting exports in order to help balance the trade or fiscal budgets. It is this lead IMF role in the use of conditionality that led G-7 ministers at the Halifax summit in June to support a strengthening of the IMF's surveillance function and, perhaps more importantly, to support providing sufficient resources to help manage such financial shocks effectively.

The G-7 ministers also stressed the importance of continued trade liberalization such as in financial and telecommunications services. In maintaining momentum toward further liberalization, the G-7 leaders will continue with (or look into beginning) work in areas such as—

- technical standards, intellectual property, and government procurement;
- negotiating a multilateral investment agreement in the OECD and taking up discussions on investment in the broader forum of the WTO; and
- supporting initiatives on regulatory reform to remove administrative and structural impediments to competition.

The G-7 leadership also resolved that they considered further trade liberalization efforts consistent with work—both future and underway—on making rules and policies in the field of trade and the environment more compatible; and on examining the

scope for multilateral action in the fields of trade and competition policy; and trade, employment and labor standards. (For background, see USITC, *IER*, Nov. 1994 and Dec. 1994.)

## SPECIAL FOCUS

# Reform of China's Industrial Enterprises

In 1978, after a long period of serious economic difficulties, China's leaders acknowledged the impracticality of Mao's economic ideology and began instituting changes in the country's economic management system. Decisions about the operation of productive enterprises have since been decentralized to a substantial degree, and, in an economy that was previously dominated by state planning, some sectors—notably agriculture and an increasing proportion of the industrial sector—have been flourishing under close-to-market conditions.<sup>5</sup>

China's economic reform resulted in high growth rates of its economy. During 1979–94, the first 16 full years of economic reform, China's real gross domestic product (GDP) rose at an average annual rate of 9.4 percent, compared with a 5.7-percent rate during 1953–78.<sup>6</sup> In 1994, GDP amounted to 4,380 billion yuan (Y), or \$308 billion, with a growth rate of 11.8 percent.<sup>7</sup>

As a part of the economic reform, a liberalization policy in international trade paved the way for trade expansion. China's foreign trade increased from \$29.3 billion in 1979 to \$236.7 billion in 1994. Industrial enterprises have contributed substantially to the increase in trade that has operated as an engine of growth in China. The total value of industrial production reached Y1,835.9 billion, or \$213.0 billion, accounting for 41.9 percent of 1994 GDP.

For the past decade, industrial production by locally owned and managed manufacturing firms has been outperforming the stolid state-owned enterprises

<sup>5</sup> For details on China's economic reform, see the *China Briefing Paper*, the Office of Economics' Working Paper No. 95-06-A, June 1995, (Washington, DC: U.S. International Trade Commission), pp. 5–21.

<sup>6</sup> All growth rates used in this paper are the discrete compound growth rates, which were calculated using the following equation:  $F = F^0(1 + r)t$ , where  $F$  = the value of the ending year of the period under discussion,  $F^0$  = the value of the initial year of the period,  $r$  = rate of growth, and  $t$  = the number of years covered by the period. Unless otherwise stated, all data and figures used in this article are from various issues of the *Statistical Yearbook of China*, published by the Chinese State Statistical Bureau.

<sup>7</sup> According to the International Monetary Fund (IMF), *International Financial Statistics*, Aug. 1995, the annual average exchange rate between the U.S. dollar and the Chinese Yuan in 1994 was 8.6187 (1USS = Y8.6187). The annual average rates in 1993 and 1992 were 2.9367 and 5.7620, respectively.

(SOEs), whose output now accounts for less than half of China's total industrial output. A true labor market is also emerging, as reflected in the growing share of wages that are tied to productivity. Competition between enterprises is increasing as the free market portion of the economy increases.

The purpose of this article is twofold: to provide information on ownership of China's enterprises and to analyze system reforms of China's publicly owned enterprises. The article is based on a recently released Office of Economics working paper detailing China's economic reforms and assessing present day issues.<sup>8</sup>

## Changes in Industrial Enterprise Ownership

According to the concept of socialism, the means of production should belong to the state. Before 1978, there were no large private enterprises in China.<sup>9</sup> All industrial enterprises were owned by national or local government. There were two types of enterprise ownership—SOEs and collectively owned enterprises (COEs). Most SOEs were situated in urban areas, and most COEs were located in rural areas. In the late 1970s, communes ran most of the COEs. Most large and medium-sized enterprises were run by the state and were under the planning of the State Planning Commission.<sup>10</sup>

<sup>8</sup> James Thao and Janet Whistler, *China Briefing Paper*, the Office of Economics' Working Paper No. 95-06-A, June 1995, (Washington, DC: U.S. International Trade Commission), p. 64.

<sup>9</sup> Some small private businesses were in existence before 1958. After 1957, they were transformed into publicly owned enterprises. For more details on changes in enterprise ownership, see the *China Briefing Paper*, pp. 10–13.

<sup>10</sup> There are two sets of criteria for distinguishing among large, medium-sized, and small enterprises in China. One is based on the annual production capacity of the enterprises in a particular industry. For instance, a steel complex that puts out one million tons of steel or more annually is considered large; between 100,000 and one million tons, medium; and below 100,000 tons, small. A cotton mill that has 100 thousand or more spindles is large; between 50,000 and 100,000, medium; and below 50,000, small. The other set of criteria is based on the original value of an individual enterprise's fixed assets. This criteria are for enterprises for which production capacity cannot be readily identified. According to the *Statistical Yearbook of China* 1994, there were 4,583 large-sized enterprises and 14,156 medium-sized enterprises in China in 1993.

Since China adopted its economic reform policy in 1978, the commune system has been phasing out. The private economy has grown rapidly, and new forms of enterprise have emerged. Enterprise ownership can now be classified in three major categories—public, private, and mixed.<sup>11</sup>

**Public ownership.**—Publicly-owned enterprises include both SOEs and COEs. In 1993, industrial SOEs were China's the largest employer, with 45 million employees, accounting for 67.9 percent of the total workers in the industrial sector. However, their share of output was only of 43.1 percent of China's gross industrial output.

COEs are those enterprises whose means of production are owned collectively. They are run by local governments or organizations at the county, township, and village levels. Because COEs have some private capital, some researchers argue that they are not publicly owned enterprises. The Chinese Communist authorities would probably prefer to include COEs in the public sector, as they claim that China's economy is primarily a socialist one and that the market economy is secondary. As the COEs were located mostly in townships or villages, they were among the first enterprises to be reformed.<sup>12</sup> In 1993, COEs had 17 million employees, accounting for 25.7 percent of the total employment in the industrial sector.

Generally, the reform of township and village enterprises has been successful.<sup>13</sup> When the commune system was being dissolved in 1981, the shares of gross industrial output of SOEs and COEs were 78.30 percent and 21.04 percent, respectively.<sup>14</sup> The remaining output (0.66 percent) was contributed by private enterprises. By 1993, the share of the COEs increased to 38.4 percent. In the same year, the shares of the individually owned enterprises (IOEs) and other ownership enterprises were 8.3 and 10.2 percent, respectively.<sup>15</sup>

<sup>11</sup> There are a few different classifications of China's industry ownership. Some researchers classified enterprises into state and nonstate; whereas, others classified them as domestic and foreign-funded enterprises.

<sup>12</sup> Prior to 1984, rural enterprises that were run by village and cooperative organizations were categorized as a part of agriculture and were grouped under industry after 1985.

<sup>13</sup> For reforms of township and village enterprises, see A.J. Ody, "Rural Enterprise Development in China, 1986-90," World Bank Discussion Paper No. 162; and "China, Feature: Township Enterprises Developing Vigorously," *Pacific Rim Economic Review*, (Washington, DC: Foreign Broadcast Information Service), July 12, 1995, pp. 6-8.

<sup>14</sup> The gross industrial output amounted to Y512 billion in 1981. There were about 299,000 COEs of which 186,000 were run by communes. COEs run by communes were relatively smaller enterprises.

<sup>15</sup> Other ownership enterprises mentioned here refer to share-holding ownership, foreign-funded enterprises, and industrial enterprises invested by overseas Chinese businessmen from Hong Kong, Macao, Taiwan, and other places.

In addition to the SOEs and COEs, some enterprises are owned jointly by state and local organizations. These are included in the category of public ownership, even though some COEs, like some SOEs, have a very small portion of their capital financed by private sources. Public ownership still plays a major role in China's industry structure.

**Private ownership.**—The private ownership category consists mainly of enterprises owned by individual households, which are primarily small businesses. Most IOEs are located in rural areas. Under the economic reform programs, the number of IOEs has risen significantly. In 1983, the National People's Congress adopted legislation assuring the right of private enterprises to employ a substantial numbers of workers.<sup>16</sup> During 1985-92 period, their share of total industrial output value increased from 1.8 to 6.8 percent.

**Other ownership.**—Other ownership consists primarily of foreign-funded enterprises (FPEs), including not only those owned jointly by Chinese and foreign investors but also wholly foreign-owned enterprises (classified by some economists as private businesses). The share of this ownership category in China's total industrial output value increased from 1.2 percent in 1985 to 7.1 percent in 1992. Moreover, the value of the output of FPEs increased by 46.2 percent in 1993, more rapidly than that of any other sector of industry. Using the growth rates that China reported for each sector in 1993, the Central Intelligence Agency has calculated that the share generated by FPEs accounted for 11.0 percent of China's total industrial output value, representing an annual increase of nearly 4 percentage points.<sup>17</sup>

## Industrial Enterprises Performance in 1994

According to the State Statistical Bureau's "Commuque on 1994 Economic Development," China's industrial output amounted to Y1,835.9 billion, with a growth rate of 18 percent. In 1994, the growth rates of output in different ownership forms of enterprises varied. The fastest growing group was the FPEs, with an annual growth rate of 28 percent; the slowest growing group was the SOEs, with an annual growth rate of 5.5 percent. In the same year, the growth rate of the COEs was 21.4 percent, of which township enterprises grew by 27.3 percent. Large and medium

<sup>16</sup> The Economist Intelligence Unit, *Country Profile: China, Mongolia, 1993/94*, (London: The Economic Intelligence Unit Ltd., 1993), p. 22.

<sup>17</sup> Central Intelligence Agency, *China's Economy in 1993 and 1994: The Search for a Soft Landing*, report prepared for the Congress, Joint Economic Committee, Subcommittee on Technology and National Security, July 1994, p. 11.

enterprises maintained their momentum of steady development, with a growth rate of 12 percent. Inefficiency of the SOEs is probably a main factor affecting the growth rate.

As mentioned in the 1994 communiqué, the major problems in China's economic development were excessive increases in market prices, stagnant agricultural development, and the fact that some state-owned enterprises were still confronted with difficulties, such as a shortage of capital and increased losses. According to Chinese authorities, the reform of the SOEs is the key to the country's economic restructuring in 1995.<sup>18</sup>

## *Reform of State-Owned Enterprises*

The reform of state enterprises is also called the reform of urban enterprises, as most of these firms are situated in densely populated areas. Since 1978, a number of changes in the SOEs' management system have been made in order to elevate their efficiency. A few significant ones are discussed in this section.

Prior to the 1978 economic reform, the guaranteed privileges of SOEs included planned allocation of cheap resources, guaranteed fixed prices for their products, soft credit for meeting investment demands, and secure employment for workers.<sup>19</sup> Since there was no competition under the centrally planned economy, these guarantees might adversely affect the efficiency of individual enterprises. After adoption of the open-door policy in 1978, competition between the SOEs and private enterprises emerged. The central planning authorities need to take the necessary actions to improve the competitiveness and productivity of the SOEs.

**Contract Responsibility System.**—The contract responsibility system (CRS) is the major instrument for China's economic reform. By signing contracts, the central government decentralizes its control to production units. The system gives production units greater control of their own allocation and distribution, with the proviso that they must first fulfill specific contractual obligations.<sup>20</sup> CRS has been success-

<sup>18</sup> Statement by Wang Zhongyu, Minister in Charge of the State Economic and Trade Commission, at a press conference on Mar. 7, 1995. For more details on his announcement, see the *Daily Report: China*, (Washington, DC: Foreign Broadcast Information Service), Mar. 7, 1995, p. 47.

<sup>19</sup> Cheng-shian Ouyang, *System Reform of China's State-Owned Enterprises, 1978-1993* (Taipei: Chung-Hua Institution for Economic Research), Occasional Paper Series No. 9501, Mar. 1995, pp. 5-6.

<sup>20</sup> For more detailed information about the operation of the "contract responsibility system" in state-owned enterprises, see Anthony Koo, et al., "State-Owned

fully implemented in the agricultural sector since the early 1980s. After fulfilling their quota, tax, and other obligations, farmers were free to dispose of their surplus output as they saw fit.

The CRS is also at the heart of the urban or industrial reform program and can be divided into two separate stages. In the first stage (1978-84), the system decentralized profit allocation authority and pricing policy from the central government to the enterprises and encouraged managers to maximize their profits. By contrast, a production unit could retain a portion of the net profit they earned. The contract would also specify the minimum amount of profits the enterprise must remit to the state and how additional profits would be shared among the government, the enterprise, and the workers.<sup>21</sup> In this stage, workers' participation in managing was also emphasized and many unions were activated. These actions, of course, promoted workers' morale and productivity. Another policy adopted in 1984 was the encouragement of the formation of enterprise groups, which enabled the SOEs to have subsidiaries—for example, a textile company could now run a business other than producing textiles.

The second stage (1985-93) of the CRS aimed at further decentralization of decision making on production, pricing, market, wage, and personnel management. Enterprises now have the right to sell and purchase products in excess of planned quotas at prices within the range of 20 percent above or below the planned price. They also have the right to dispose of retained profits. SOEs were also given the power to determine their own internal wage structure. In the late 1980s, they carried out the first significant wage reform in almost 20 years. This decentralized system established a closer link between the amount an enterprise allocated to wages and bonuses and its efficiency as measured by profits or losses. The new system linked wage and productivity and changed the employment policy.

The new hiring policy adopted in 1986 broke the so-called "iron rice bowl," which had guaranteed lifetime employment under the Mao Administration. After October 1983, all SOEs were supposed to offer fixed-term employment contracts to their employees. However, certain high-priority industries, such as coal mining and steel, could still offer permanent employment to attract new workers. Since the late 1980s, the payrolls of most SOEs have included three types of employment: permanent, contracted, and temporary.

<sup>20</sup>—Continued  
Enterprises in Transition," in *China's Economic Reform*, ed. by Walter Galenson (San Francisco: The 1990 Institute, 1993), pp. 33-50.

<sup>21</sup> Galenson, *China's Economic Reform*, p. 43.

*Other changes in policy.*—One major change in the SOEs was the separation of the party from management. Before the reform, the Chinese Communist Party (CCP) secretary of an enterprise was responsible for management decisions of the enterprise. After adoption of the CRS system, such decisions would be made by the president of the enterprise, who need not be a CCP member. Many enterprises are managed by technicians.

The Chinese Government has recently adopted privatization measures, including the outright sale of enterprises and the issuing of stock. The corporate structure of state enterprises can be transformed into companies with "limited liabilities," or "joint-stock" companies. In addition, the Government has encouraged profit making SOEs to form groups and have subsidiaries.<sup>22</sup> Two cities, Shanghai and Shenzhen, now have open stock markets, but only a portion of the stock of an SOE can be sold. So far, there have not been many foreign investors directly investing in SOEs.

The Chinese Government plans to sell or lease those SOEs that have suffered losses. If an SOE were leased to a private buyer, that would mean "public-ownership and private-management," a system advocated by many Chinese economists. Obviously, the lease would not change the ownership. Selling inefficient SOEs is an acceptable solution; however, few investors want to buy old and inefficient plants. Although the share of the SOEs in gross industry output declined during 1985-93, the number of SOEs increased from 3,815 to 4,498 for the same period. These inefficient SOEs have remained open, and have become a burden to the Government. They depend on Government subsidies to offset their losses and deficits. In 1992, the subsidies amounted to Y44.6 billion, or \$8.08 billion, accounting for 1.86 percent of GDP.

## Major Problems in SOEs

Many research and policy papers point out numerous problems existing in SOEs and offer different answers to the problems. Some of the problems, such as corruption and tax evasion, may be difficult to correct, whereas others, like location and outdated equipment, do not have quick solutions. A few major problems were selected for discussion in this section.

<sup>22</sup> For instance, Shoudu Iron and Steel Company, a large-sized SOE, has several subsidiaries, including Shougang Beijing Iron and Steel Co., Shougang Mechanical Engineering Co., Shougang Construction Co., Shougang Electronic Co., Shougang Industrial Co., and Shougang Special Steel Co.

*Outdated machines and facilities.*—Before establishment of the People's Republic of China in 1949, many large enterprises in several industries, such as defense, public utilities, steel, coal, mining, machinery, and textiles, were owned by the state. Many of them were built in the early 20th century.<sup>23</sup> Three wars (Revolutionary, Second World, and Civil) slowed down industrial modernization in China. In the 1950s, China built, with assistance rendered by the Soviet Union, a number of industrial enterprises whose equipment is now aging. These older facilities render many SOEs inefficient and less competitive. China is not capable of modernizing these SOEs; foreign investors are more interested in investing in other types of enterprises, such as COEs and solely foreign-funded firms. Furthermore, some newly established SOEs may be equipped with secondhand machines.<sup>24</sup>

*Community services burden.*—In many cases, an SOE is also an independent community. Community services are major burdens for SOEs, especially for these large and medium-sized ones. The community service facilities include schools, hospitals, post offices, recreation facilities, guest houses and hotels, credit unions, restaurants, and others. A large-sized enterprise may have its own university, and a medium-sized enterprise may have its own vocational school. Both enterprises may have nursery, primary, and secondary schools. All employees of these service facilities are on the payroll of the local enterprise.

If the Government decides to close an enterprise, it could mean closing a community or the end of community services. In this case, the Government would have to establish a new hospital and new schools for the local people, which would be costly. This is a major reason why the Government continues to subsidize inefficient SOEs, and keeps them in operation. At present, about one-third of the SOEs are operating in the red. They may be sold or rented. It is unlikely that these inefficient SOEs will be dissolved. Chinese statistics show that, during 1985-93, the total number of SOEs did not decline. Instead, they increased from 93,700 to 104,700.<sup>25</sup>

To resolve the problems of the SOEs is the priority work for economic reform this year, as announced by the Chinese Government. Certainly, it will not be an easy job.

<sup>23</sup> For instance, Benxi Iron & Steel Co., a large-sized SOE, was established in 1905, and Anshan Iron & Steel Co., the largest steel producer in China, was established in 1916.

<sup>24</sup> For instance, Shanghai Baoshan Iron & Steel General Works, the newest steel mill in China, completed its second phase construction work in 1991. The Government bought secondhand equipment and machines for the steel mill from Japan out of financial necessity.

<sup>25</sup> *The Statistical Yearbook of China 1994*, p. 373. The number includes SOEs in all sectors.

**BLANK PAGE**

**32**

## **APPENDIX**

### **Office of Economics Working Papers - List**



## Office of Economics Working Papers U.S. International Trade Commission October, 1995

The following is a list of Office of Economics working papers. Copies of unpublished papers which are currently available can be obtained from the Office of Economics. Please request working papers by reference date/code, title, and author. Address requests to: Office of Economics, U.S. International Trade Commission, 500 E Street SW, Washington DC 20436, USA, or by fax at (202) 205-2340.

Reference Date/Code	Title	Authors	Status
1995 95-07-A	Transition to A Market Economy in the Countries of the Central European Free Trade Agreement (Visegrad Group)	*Peter Pogany	WORKING PAPER
95-08-D	After NAFTA: Western Hemisphere Trade Liberalization and Alternative Paths To Integration	*Sandra A. Rivera	Social Science Journal, vol. 32, no. 4, Oct. 1995
95-08-C	International Trade, Labor Standards & Labor Markets Conditions: An Evaluation of the Linkages	*Mita Aggarwal	WORKING PAPER
95-08-B	Economic Policies and Developments in the countries of the Central European Free-Trade Agreement (VISEGRAD GROUP) DURAG 1990-1995	*Peter Pogany	WORKING PAPER
95-08-A	China Briefing Paper	*James Teas and *Janet Whistler *Michael J. Fermanino	WORKING PAPER
95-04-A	International Trade, Environmental Quality and Public Policy	*Michael J. Fermanino	WORKING PAPER
95-08-A	Export Diversification and Structural Dynamics in the Growth Process: The Case of Chile	Sheila Amin Gutierrez-de Pittiers and *Michael J. Fermanino	WORKING PAPER
1994 94-12-C	Regional Trade Arrangements and Global Welfare	*Nancy Bentzen	WORKING PAPER
94-12-B	The General Equilibrium Implications of Fixed Export Costs on Market Structure and Global Welfare	*Michael P. Galloway	WORKING PAPER
94-11-B	Economic Analysis for Trade and Environment - An Introduction	*Michael J. Fermanino	WORKING PAPER
94-11-A	A Brief Description of International Institutional Linkages in Trade and Environment	*Michael J. Fermanino	WORKING PAPER
94-10-B	Explaining Japanese Acquisitions in the United States: The Role of Exchange Rates	*Bruce Blonigen	WORKING PAPER
94-10-A	The Cash Recovery Method and Pharmaceutical Profitability	*Christopher T. Taylor	WORKING PAPER
94-06-A	Towards a Theory of the Biodiversity Treaty	*Michael J. Fermanino	WORKING PAPER
94-07-A	Free Trade Areas and Tariffs Against a Natural Background	Dale Boleco *Michael Fermanino	WORKING PAPER
94-08-A	Estimating Tariff Equivalents of Nontariff Barriers	*Linda A. Linkins and *Hugh M. Arce	WORKING PAPER
1993 93-11-A	A Computable General Equilibrium Estimation of the Effects of the U.S. Meat Program	*Gerald Berg Kenneth A. Reinert	WORKING PAPER
93-08-A	Tariffs, Rent Extraction and Manipulation of Competition	*Theodore Tso	WORKING PAPER
93-08-A	Trade Policy and Employment in General Equilibrium	Karen E. Thierfelder *Clinton R. Shiells	WORKING PAPER

Reference Date/Code	Title	Author(s)	Status
1992			
92-11-F	The Structure of Simple Political-Economy Models: The Endogenous Policy Approach	*H. Keith Hall Douglas Nelson	WORKING PAPER
92-11-E	Women and Tariffs: Testing the Gender Gap Hypothesis in a Down-Mayer Political-Economy Model	*H. Keith Hall Chihsia Kao Douglas Nelson	WORKING PAPER
92-11-D	Taiwan's Trade Liberalization and Surpl. 1, 1985-1990	*James T.H. Tsoo	<i>Research in Asian Economic Studies</i> , vol. 4A, pp. 179-199 JAI Press, 1992
92-11-C	Primary Production and Trade in the Pacific Basin	*James T.H. Tsoo	WORKING PAPER
92-11-B	U.S. Trade Policy and the Caribbean Basin: Aid Through Trade or Immunization?	*Hugh Arce *Clint Shields	WORKING PAPER
92-11-A	A Multidimensional Analysis of U.S. Industry's International Performance	Robert A. Blecker	WORKING PAPER
92-10-B	Estimates of the Demand for Selected Pharmaceutical Drugs Across Countries and Time	*Robert M. Feinberg Donald L. Alexander *Joseph E. Flynn *Linda A. Linkins	WORKING PAPER
92-10-A	Innovation, R&D Productivity, and Global Market Share in the Pharmaceutical Industry	Donald L. Alexander *Joseph E. Flynn *Linda A. Linkins *Keith B. Anderson	WORKING PAPER
92-09-A	Antidumping Laws in the United States: Use and Welfare Consequences	*Keith B. Anderson	WORKING PAPER
92-09-B	Dynamic Effects of International Trade in Financial Services	*Joseph F. Francois	WORKING PAPER
92-09-A	Imperfectly Competitive Financial Markets, Trade in Services, and Financial Market Integration	*Joseph F. Francois	WORKING PAPER
92-09-A	A Note on Appreciation and the Welfare Analysis of Tariffs: Evidence From The United States	*Hugh M. Arce *Kenneth A. Reinert	WORKING PAPER
92-09-E	Social Accounts and the Structure of the North American Economy	*Kenneth A. Reinert David W. Roland-Holst *Clinton R. Shields	<i>Economic Systems Research</i> , 5:3, 1993, pp. 295-326
92-09-D	North American Trade Liberalization and the Role of Nontariff Barriers	David Roland-Holst *Kenneth A. Reinert *Clinton R. Shields *Joseph F. Francois	WORKING PAPER
92-09-C	Commercial Policy and Infant Industries with International Returns to Scale — A Geometric Note	*Joseph F. Francois	WORKING PAPER
92-09-B	Global Production and Trade: Commercial Policy with International Returns to Scale	*Joseph F. Francois	WORKING PAPER
92-09-A	Commercial Policy and the Domestic Carrying Trade: A General Equilibrium Assessment	*Joseph F. Francois *Hugh M. Arce *Kenneth A. Reinert *Joseph E. Flynn *Joseph E. Flynn *Kenneth A. Reinert	WORKING PAPER
92-02-A	The Welfare and Resource Allocation Effects of the U.S. Dairy Quotas	*Joseph F. Francois *Hugh M. Arce *Kenneth A. Reinert *Joseph E. Flynn *Joseph E. Flynn *Kenneth A. Reinert	<i>Int'l Economic Journal</i> , vol. 7 No. 2, Summer 1993, pp. 91-106
92-01-B	Telecommunications Network Quality and the Pattern of Trade	Kenneth T. Boatman *Joseph F. Francois	WORKING PAPER
92-01-A	The Role of Services in U.S. Production and Trade: An Analysis of Social Accounting Data for the 1980s	Ranjit S. Dighe *Joseph F. Francois *Kenneth A. Reinert	Forthcoming in <i>The Services Productivity Challenge</i> , P. Harker, editor, Kluwer Press.

Reference Date/Code	Title	Authors	Status
1991 91-10-A	Countervailing the Effects of Subsidies: An Economic Analysis	*Joseph F. Francois	<i>Journal of World Trade</i> , vol 26, No. 1, 1992 (February), pp. 5-14. WORKING PAPER
91-08-D	The Relative Price Discipline of Domestic versus Foreign Entry	*Robert Feinberg	
91-08-C	Immigration Reform: The Effects of Employer Sanctions and Legalization of Wages	Joseph Shrenen Deborah A. Cobb-Clark *Clinton R. Shiells B. Lindsey Lowell *Walker A. Pollard	WORKING PAPER
91-08-B	Effects of California Proposition 138, Drought, and Changes in Water Policy on U.S. International Trade		WORKING PAPER
91-08-A	Armington Models and Terms-of-Trade Effects: Some Econometric Evidence for North America	*Clinton R. Shiells *Kenneth A. Reinert	<i>Canadian Journal of Economics</i> , <i>Economics</i> , vol. 26; 2 1993 (May), pp. 290-316.
91-08-C	Textile and Apparel Protection in the United States: A General Equilibrium Analysis	*Kenneth A. Reinert	<i>World Economy</i> , vol. 16, No. 3 (May 1993), pp. 359-376.
91-08-B	Modeling a North American Free Trade Area: Estimation of Flexible Functional Forms	*Clinton R. Shiells David W. Roland-Holst *Kenneth A. Reinert	<i>Weltwirtschaftliches Archiv</i> , vol. 129: 1, 1993, pp. 55-77.
91-08-A	The Welfare Effects of Import "Subquotes" on Heterogeneous Product Categories	*Gerald C. Berg Eric W. Bond	<i>Zeitschrift für Nationalökonomie</i> , vol. 54, No. 3 1991, pp. 251-265.
91-07-A	Market Structure and the Benefits of Financial Market Integration	*Joseph F. Francois	WORKING PAPER
91-08-B	Disaggregated Armington Elasticities for the Mining and Manufacturing Sectors of the United States	*Kenneth A. Reinert David W. Roland-Holst	<i>Journal of Policy Modelling</i> , vol. 14:5, 1992.
91-08-A	Discriminatory Export Taxation in Costa Rica: A Counterfactual History Using Applied General Equilibrium Analysis	*Kenneth A. Reinert	WORKING PAPER
91-05-A	Errors in Import-Demand Estimates Based Upon Unit-Value Indexes	*Clinton R. Shiells	<i>The Review of Economics and Statistics</i> , LXXIII (May 1991) 376-382.
91-04-A	Japanese Loan Subsidies for Structural Adjustment and their Effects on Trade with the United States (revised 3/10/92)	*Walker A. Pollard *Gerald C. Berg	<i>International Economic Journal</i> , vol. 8, No. 1 (1994), pp. 1-10.
91-03-A	Structural Change in the United States: Social Accounting Estimates for 1952-1988	*Kenneth A. Reinert David W. Roland-Holst	WORKING PAPER
91-02-B	Hysteresis and Export Targeting	*Robert M. Feinberg	<i>International Journal of Industrial Organization</i> , vol. 10, No. 4 (December 1992), pp. 679-84.
91-02-A	The U.S. Sugar Program: An Historical Review	Laurie A. Cameron	WORKING PAPER
91-01-L	Fishing Downstream: The Political Economy of Effective Administered Protection	*Gerald C. Berg *Robert M. Feinberg *Seth Kaplan	<i>Canadian Journal of Economics</i> , vol. 26, No. 1, February, 1993, pp. 150-158.
91-01-K	Endogenous Tariff Formation in a Computable General Equilibrium Model	*Stephen P. Tokerick	WORKING PAPER
91-01-J	United States Adjustment in the 1980s: A CGE Analysis of Alternative Trade Strategies	Kenneth Hanson Sherman Robinson *Stephen P. Tokerick	<i>International Economic Journal</i> , vol. 7, No. 2, Summer, 1993, pp. 27-49.

Reference Data/Code	Title	Authors	Status
91-01-I	Explaining the Pattern of Trade in Producer Services	*Joseph F. Francois	<i>International Economic Journal</i> , vol. 7, No. 3, Autumn, 1993, pp. 29-51
91-01-H	Optimal Commercial Policy With International Returns to Scale	*Joseph F. Francois	<i>Canadian Journal of Economics</i> , vol. 25, No. 1, February, 1992, pp. 184-195
91-01-G	Estimating the Welfare Cost of U.S. Tariffs: The Role of the Work-Leisure Choice	Donald J. Roushong *Stephen P. Tokerick	WORKING PAPER
91-01-F	A Note on the Existence of 'Natural Friends' and 'Natural Enemies'	*Stephen P. Tokerick	WORKING PAPER
91-01-E	A Detailed Social Accounting Matrix for the United States: 1988	*Kenneth A. Reinert David W. Roland-Holst	<i>Economic Systems Research</i> 4:2, 1992, 173-187.
91-01-D	Changing Product Liability Standards and New Product Introduction	*Hugh M. Arce	WORKING PAPER
91-01-C	Trade in Financial Services with Monopolistically Competitive Financial Markets	*Joseph F. Francois	WORKING PAPER
91-01-B	Trade Substitution Elasticities for Analysis of a North American Free Trade Area	*Kenneth A. Reinert *Clinton R. Shiells	WORKING PAPER (Revised as ITC Staff Paper 19)
91-01-A	Aggregate Preference Shifts, Income Distribution, and the Under Hypothesis	*Joseph F. Francois *Seth Kaplan	WORKING PAPER

Office of Economics working papers are the result of the ongoing professional research of staff economists, and thus are solely meant to represent the opinions and professional research of individual authors. Working papers are circulated to promote the active exchange of ideas between staff economists and recognized experts outside the ITC, and to promote professional development of staff by encouraging outside professional critique of staff research. These papers are not meant to represent in any way the views of the International Trade Commission, individual commissioners, or other Commission staff.

\* Staff Economist, U.S. International Trade Commission.

38

BLANK PAGE

## **STATISTICAL TABLES**

**BLANK  
PAGE**

**Indexes of Industrial production, by selected countries and by specified periods, Jan. 1992-August 1995**  
 (Total industrial production, 1991=100)

November 1995

Country	1994						1995							
	1992	1993	1994	III	IV	I	II	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
United States <sup>1</sup>	107.6	112.0	118.1	118.8	120.4	122.1	121.2	122.1	121.9	121.2	121.4	121.2	121.6	123.0
Japan	96.0	92.0	93.1	94.1	94.0	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Canada <sup>2</sup>	96.8	101.4	107.9	109.4	111.7	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Germany	101.0	93.5	96.8	97.6	99.2	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
United Kingdom	96.0	98.0	103.1	104.1	107.7	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
France	98.9	95.3	(2)	99.7	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Italy	97.8	95.7	102.2	103.7	104.6	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)

<sup>1</sup> 1987=100

<sup>2</sup> Not available.

<sup>3</sup> Real domestic product in industry at factor cost and 1985 prices.

Source: *Main Economic Indicators*; Organization for Economic Cooperation and Development, March 1995; *Federal Reserve Statistical Release*; September 15, 1995.

**Consumer prices, by selected countries and by specified periods, Jan. 1992-July 1995**  
 (Percentage change from same period of previous year)

Country	1994						1995								
	1992	1993	1994	III	IV	Dec.	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.
United States	3.0	3.0	2.6	2.9	2.7	2.7	2.8	3.1	2.8	2.9	2.9	3.1	3.2	3.0	2.8
Japan	1.6	1.3	0.7	0.0	0.8	0.7	0.1	0.0	0.6	0.2	-0.4	-0.2	0.0	0.3	(1)
Canada	1.5	1.8	0.2	0.2	0.0	0.2	1.6	2.7	0.6	1.8	2.2	2.5	2.9	2.7	2.5
Germany	4.0	4.2	3.0	3.0	2.8	2.7	2.3	2.3	2.3	2.4	2.3	2.3	2.2	2.4	2.4
United Kingdom	3.7	1.6	2.5	2.3	2.6	2.9	3.4	3.4	3.3	3.4	3.5	3.3	3.4	3.5	(1)
France	2.4	2.0	1.7	3.8	1.6	1.6	1.7	1.6	1.7	1.7	1.8	1.6	1.6	1.6	1.5
Italy	5.1	4.4	1.0	3.8	4.0	4.2	4.3	5.5	4.0	4.5	4.9	5.2	5.3	5.7	5.3

<sup>1</sup> Not available.

Source: *Consumer Price Indexes, Nine Countries*, U.S. Department of Labor, September 1995.

**Unemployment rates, (civilian labor force basis)<sup>1</sup> by selected countries and by specified periods, Jan. 1992-July 1995**

Country	1994						1995							
	1992	1993	1994	III	IV	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.
United States	7.4	6.8	6.1	6.0	5.6	5.5	5.7	5.7	5.4	5.5	5.6	5.7	5.6	5.7
Japan	2.2	2.5	2.9	3.0	3.0	3.0	3.2	2.9	3.0	3.0	3.2	3.1	3.2	(1)
Canada	11.3	11.2	10.3	10.2	9.7	9.7	9.5	9.7	9.6	9.7	9.4	9.5	9.6	9.6
Germany	4.6	5.8	6.5	6.5	6.5	6.5	(2)	6.4	6.4	6.5	6.5	6.5	6.5	6.5
United Kingdom	10.0	10.4	9.5	9.6	9.0	8.8	8.8	8.7	8.7	8.7	8.6	8.5	8.5	8.5
France	10.2	11.3	12.3	12.4	12.3	12.5	(2)	12.2	12.1	12.1	12.4	(2)	12.2	(2)
Italy	7.3	10.3	11.4	11.4	12.0	12.2	12.2	12.2	(2)	(2)	12.2	(2)	(2)	(2)

<sup>1</sup> Seasonally adjusted; rates of foreign countries adjusted to be comparable with the U.S. rate.

<sup>2</sup> Not available.

<sup>3</sup> Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.

Source: *Unemployment Rates in Nine Countries*, U.S. Department of Labor, September 1995.

Money-market interest rates,<sup>1</sup> by selected countries and by specified periods, Jan. 1992-August 1995  
 (Percentage, annual rates)

Country	1994					1995									
	1992	1993	1994	III	IV	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
United States .....	3.7	3.2	4.6	4.6	5.6	6.2	6.0	6.2	6.2	6.1	6.1	6.0	5.9	5.7	5.70
Japan .....	4.4	2.9	2.2	2.2	2.3	2.2	(3)	2.3	2.3	2.1	1.5	1.3	1.1	0.9	0.9
Canada .....	6.7	5.1	5.5	5.8	5.9	8.1	(3)	7.8	8.4	8.3	8.1	7.5	7.0	6.6	6.6
Germany .....	9.4	7.1	4.0	4.8	5.1	4.9	(3)	5.0	5.0	4.9	4.5	4.4	4.4	4.4	4.4
United Kingdom .....	9.5	5.8	5.4	5.3	6.0	6.6	(3)	6.5	6.7	6.6	6.6	6.6	6.7	6.7	6.7
France .....	10.1	8.3	5.7	5.5	5.5	5.7	(3)	5.7	5.7	7.7	7.6	7.2	7.0	6.3	6.3
Italy .....	13.0	10.0	8.4	8.5	8.8	9.7	(3)	9.1	9.1	10.9	10.9	10.3	10.9	10.9	10.9

<sup>1</sup> 90-day certificate of deposit.

<sup>2</sup> Not available.

Source: *Federal Reserve Statistical Release*, September 11, 1995; *Federal Reserve Bulletin*, September 1995.

Effective exchange rates of the U.S. dollar, by specified periods, Jan. 1992-August 1995  
 (Percentage change from previous period)

Item	1994					1995							
	1992	1993	1994	III	IV	I	II	Mar.	Apr.	May	Jun.	Jul.	Aug.
Unadjusted:													
Index <sup>1</sup> .....	97.0	100.1	98.5	98.5	95.9	96.0	89.7	92.4	89.3	89.9	89.8	90.0	92.1
Percentage change .....	-1.5	3.1	-1.6	-3.5	-6	.1	-7.0	-3.6	-3.3	.6	-.1	.2	2.1
Adjusted:													
Index <sup>1</sup> .....	100.9	104.2	101.5	99.9	98.0	95.1	90.8	92.9	90.5	91.0	90.9	91.3	94.1
Percentage change .....	-.1	3.3	-2.7	-3.6	-1.9	-2.9	-5.1	-3.9	-2.6	.5	-.1	.4	2.8

<sup>1</sup> 1990 average=100.

Note.—The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 18 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

Source: Morgan Guaranty Trust Co. of New York, September 1995.

**Merchandise trade balances, by selected countries and by specified periods, Jan. 1992-July 1995**  
 (In billions of U.S. dollars, Exports less Imports (f.o.b - c.i.f.), at an annual rate)

Country	1994					1995					
	1992	1993	1994	III	IV	I	II	Apr.	May	Jun.	Jul.
United States <sup>1</sup>	-84.5	-115.7	-151.3	-164.5	-157.1	-167.5	-174.3	-177.5	-168.6	-176.7	-187.7
Japan	106.4	120.3	125.3	113.5	124.7	125.3	125.3	125.3	125.3	125.3	125.3
Canada <sup>2</sup>	12.1	13.3	18.0	20.1	24.7	26.0	26.0	26.0	26.0	26.0	26.0
Germany	21.0	35.8	45.6	40.2	55.2	55.3	55.3	55.3	55.3	55.3	55.3
United Kingdom	-30.8	-25.5	-15.3	-23.0	-23.0	-23.0	-23.0	-23.0	-23.0	-23.0	-23.0
France <sup>3</sup>	5.8	15.8	15.8	15.6	23.0	23.0	23.0	23.0	23.0	23.0	23.0
Italy	-6.8	20.6	27.6	27.6	27.6	27.6	27.6	27.6	27.6	27.6	27.6

<sup>1</sup> Figures are adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f. value.

<sup>2</sup> Not available.

<sup>3</sup> Imports are f.o.b.

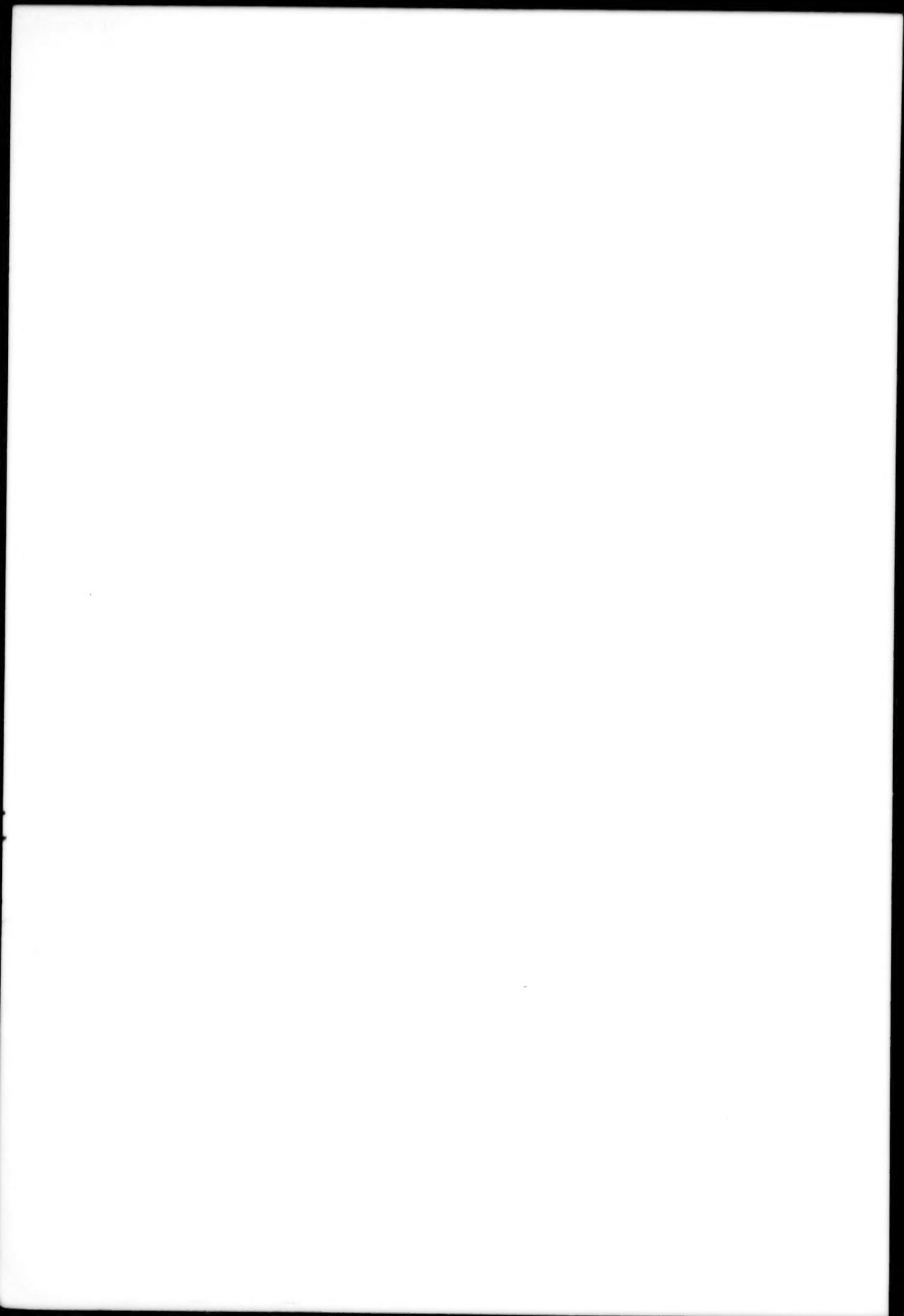
Source: Advance Report on U.S. Merchandise Trade, U.S. Department of Commerce, September 20, 1995; Main Economic Indicators; Organization for Economic Cooperation and Development, March 1995.

**U.S. trade balance,<sup>1</sup> by major commodity categories and by specified periods, Jan. 1992-July 1995**  
 (In billions of dollars)

Country	1994					1995					
	1992	1993	1994	IV	I	II	Mar.	Apr.	May	Jun.	Jul.
<b>Commodity categories:</b>											
Agriculture	18.6	17.8	19.0	8.9	8.2	4.9	2.1	1.9	1.6	1.4	1.6
Petroleum and selected products— (unadjusted)	-43.9	-45.7	-47.5	-11.5	-11.6	-12.8	-4.3	-3.9	-4.5	-4.4	-4.3
Manufactured goods	-98.7	-115.3	-155.7	-47.5	-40.3	-43.0	-13.0	-13.6	-13.8	-15.6	-18.2
<b>Selected countries:</b>											
Western Europe	0.2	-1.4	-12.5	-3.6	-1.1	-2.9	.3	-4	-9	-1.6	-3.1
Canada	-7.9	-10.2	-14.5	-4.8	-2.4	-4.0	-5	-1.5	-8	-1.7	-1.4
Japan	-40.4	-59.9	-65.6	-18.2	-15.0	-16.4	-5.6	-5.8	-5.4	-5.2	-5.1
OPEC (unadjusted)	-11.2	-11.6	-13.8	-3.2	-1.6	-3.7	-6	-1.2	-1.3	-1.2	-1.5
Unit value of U.S. imports of petroleum and selected products (unadjusted)	\$16.80	\$15.13	\$14.22	\$14.95	\$15.43	\$16.97	\$15.76	\$16.71	\$17.39	\$16.81	\$15.80

<sup>1</sup> Exports, f.a.s. value, unadjusted. Imports, customs value, unadjusted.

Source: Advance Report on U.S. Merchandise Trade, U.S. Department of Commerce, September 20, 1995.



LAND

047.99